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PUBLIC HEARING

before

SENATE LABOR, INDUSTRY, AND PROFESSIONS COMMITTEE

SENATE BILL 1718
(Establishes the New Jersey Intergovernmental Excess Liability Commission)

March 5, 1986
Room 334
State House Annex
Trenton, New Jersey

MEMBERS OF COMMITTEE PRESENT:

Senator Raymond Lesniak, Chairman

ALSO PRESENT:

Dale C. Davis, Jr.
Office of Legislative Services
Aide, Senate Labor, Industry, and
Professions Committee

New Jersey State Library

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Hearing Recorded by
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State of New Jersey

SENATE LABOR, INDUSTRY,
AND PROFESSIONS COMMITTEE
CN-042
STATE HOUSE ANNEX, TRENTON, N.J. 08625
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February 19, 1986

NOTICE OF PUBLIC HEARING

The Senate Labor, Industry and Professions Committee will hold a public hearing on Wednesday, March 5, 1986, at 1:00 P.M., in Room 334, State House Annex, on the following bill:

S-1718 Lesniak — Establishes the New Jersey Intergovernmental Excess Liability Commission to insure certain units of government against certain liability claims within certain limits.

Anyone wishing to testify should contact Dale Davis, Committee Staff, at 609-984-0445.

[SECOND OFFICIAL COPY REPRINT]

SENATE, No. 1718

STATE OF NEW JERSEY

INTRODUCED FEBRUARY 24, 1986

By Senators LESNIAK and LYNCH

Referred to Committee on Labor, Industry and Professions

AN ACT creating the New Jersey Intergovernmental Excess Liability Commission to provide certain insurance coverages to *[units of government]* *certain public entities* in this State *and amending N. J. S. 59:9-2*.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. *(New section)* a. The New Jersey Intergovernmental Excess Liability Commission is established and shall insure, within certain limits, every *[unit of government subject to the "Local Public Contracts Law," P. L. 1971, c. 198 (C. 40A:11-1 et seq.), the "Public School Contracts Law," N. J. S. 18A:18A-1 et seq., the "County College Contracts Law," P. L. 1982, c. 189 (C. 18A:64A-25.1 et seq.) and P. L. 1954, c. 48 (C. 52:34-6 et seq.), including, but not limited to, municipalities, counties, school districts, public institutions of higher education, utility commissions, and the State]* *[of New Jersey]* *public entity as defined in N. J. S. 59:1-3, but shall not include any entity within the definition of State as defined in N. J. S. 59:1-3 nor any State commission or State authority which is statutorily authorized to sue and be sued*, and the officials, employees and agents of these *[units of government]* *public entities* while acting, within the scope of their duties, against liability imposed by law for bodily injury, personal injury, property damage or wrongful acts. For the purpose of this act, a wrongful act means any actual or alleged error, or misstatement or misleading statement, or act or omission, or neglect or breach of duty, including misfeasance, malfeasance and nonfeasance. *Every public entity subject to the provisions of this act*

EXPLANATION—Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and is intended to be omitted in the law.

Matter printed in italics *thus* is new matter.

Matter enclosed in asterisks or stars has been adopted as follows:

*—Senate committee amendments adopted May 5, 1986.

**—Senate amendment adopted May 5, 1986.

*shall be a member of the New Jersey Intergovernmental Excess Liability Commission and shall be subject to the provisions of this act, except that any public entity which demonstrates to the satisfaction of the commission that it is able to secure liability coverage that is comparable or better than that provided pursuant to this act at a cost that is less than that charged by the commission, shall not be required to be a member of the commission and be insured by it.**

b. The commission shall be responsible for self-insuring or securing insurance, or both, for liabilities as defined in this section caused by any event which occurs on or after the 30th day following the approval of its bylaws and plan of risk management pursuant to section 6 of this act. For the purpose of this act, the date an event occurred shall be the date the bodily injury, personal injury or property damage was manifested, or the date a claim for an alleged wrongful act was first made.

c. Each member *[unit of government]* **public entity** shall be responsible for or pay the first $500,000.00 of any liability claim for each covered event before the commission shall be responsible to pay, within the limits set by this subsection and subsection e. of this section, for the remainder of the claim caused by the event. The commission shall not be responsible for defense costs and other claim adjusting expenses incurred by the member *[unit of government]* **public entity**, for workers' compensation liability, employer's liability, or damage to property owned by or under the custody or control of the member *[unit of government]* **public entity**. Each accident shall constitute a separate event, except if the claims are caused by pollution, all claims incurred from a contaminated site shall be counted together as a single event. Each landfill and municipal water system shall constitute a single site. Each *[unit of government]* **public entity** may purchase insurance, self-insure, or form a joint insurance fund to pay for its liability under this section.

d. The commission shall not be liable for claims based on alleged wrongful acts arising out of the following:

(1) The gaining of any personal profit or advantage to which the defendant is not legally entitled;

(2) The return of any remuneration paid in fact to the defendant if payment of that remuneration shall be held by the courts to be in violation of law;

(3) The dishonesty of the defendant, except that, notwithstanding the foregoing, any official, employee or agent of a member *[unit of government]* **public entity** shall be protected as to

any action brought against him by reason of any alleged dishonesty, unless a judgment or other final adjudication thereof adverse to him shall establish that acts of active and deliberate dishonesty committed by him with actual dishonest purpose and intent were material to the cause of action so adjudicated;

(4) Demands or actions seeking relief, or redress, in any form other than money damages;

(5) Demands for fees or expenses relating to claims, demands or actions seeking relief or redress, in any form other than money damages;

(6) Inverse condemnation.

e. The commission shall be responsible for no more than $20,000,000.00, excluding defense costs, for liability claims caused by a single event, even if the single event involves more than one member *[unit of government]* *public entity*. Each member *[unit of government]* *public entity* may self-insure, purchase insurance or form a joint insurance fund, or any combination thereof, to cover liabilities in excess of the commission's responsibility under this act.

f. The commission shall have the benefit of any insurance policy or coverage which was issued to a member *[unit of government]* *public entity* which would have otherwise paid for a liability claim which is the responsibility of the commission, except that portion of any insurance policy or coverage under a policy or coverage period after the 29th day following the approval of the commission's bylaws and plan of risk management pursuant to section 6 of this act. Any insurance policy or coverage under a policy or coverage period after the 29th day following the approval of the commission's bylaws and plan of risk management pursuant to section 6 of this act, and covers liabilities which are the responsibility of the commission or for that portion of the policy or coverage, as the case may be, shall be cancelled on the 30th day following the approval of the commission's bylaws and plan of risk management pursuant to section 6 of this act, and the insurer shall pay the member *[unit of government]* *public entity* a pro rata return of premium. The insurer shall be reimbursed by the commission for any claims paid under any portion of any policy or coverage cancelled under this section.

g. In the event of any payment, the commission shall be subrogated to all the rights of recovery therefor against any person or organization and the member *[unit of government]* *public entity* shall execute and deliver such instruments and papers and do whatever else is necessary to secure such rights. The member

[unit of government] *public entity* shall do nothing after the loss to prejudice such rights. In the event of a claim, the member *[unit of government]* *public entity*, and its officials, employees and agents shall take reasonable measures to protect its and their interests. If defense of an action shall be required, then the member *[unit of government]* *public entity* shall appoint counsel. No costs or expenses shall be incurred on behalf of the commission under any circumstances without its consent. The commission, at its option, shall have the right at its own expense to investigate any claim or negotiate the settlement thereof, as it deems expedient, but the commission shall not commit the member *[unit of government]* *public entity* or its officials, employees or agents to any settlement without its or their consent. If, however, the defendant shall refuse to consent to any settlement recommended by the commission and shall elect to contest the claim or continue any legal proceedings in connection with such claim, then the commission's liability for the claim shall not exceed the amount for which the claim could have been settled including costs, charges and expenses incurred with its consent up to date of such refusal.

2. *(New section) The commission shall consist of nine commissioners.* Upon the establishment of the commission, the Governor shall appoint, with the advice and consent of the Senate, *[seven]* *eight* commissioners *[who shall serve staggered terms of two years]*; provided, however, that *[one commissioner]* *two commissioners* shall be *[an employee]* *employees* or *[an official]* *officials* of a municipality; one commissioner shall be an employee or an official of a board of education; *[one commissioner shall be an employee or an official of an institution of higher education]*; one commissioner shall be an employee or an official of a county; one commissioner shall be an employee or an official of a utility commission; *[and two commissioners]* *one commissioner* shall be *[employees or officials of the State government]* ***a licensed insurance agent recommended by a recognized insurance agent association; and two commissioners shall be public members of whom one shall have experience in insurance risk management***. *The ninth commissioner shall be the Commissioner of Insurance or his designee, and he shall serve ex officio.* The Governor shall remove from office any commissioner who ceases to be an official or an employee of the type of *[unit of government]* ***public entity*** he was appointed to represent. *The appointed members shall serve for terms of three years, except that of the*

*members first appointed, two shall serve for terms of one year, three for terms of two years, and three for terms of three years.** Terms of office shall expire July 1st, or until a successor is appointed. On July 1st of each year, or as soon as possible thereafter, the commissioners shall elect a chairman and a secretary from its membership.

3. **(New section)** The commissioners shall have the following powers and authority to:

a. Enter into contracts as are necessary or proper to carry out the provisions and purposes of this act;

b. Sue and be sued in the name of the commission, including taking any legal actions necessary or proper for recovery of any assessments against members. A judgment against the commission shall not create any direct liability against the commissioners;

c. Indemnify its commissioners, employees and agents for any and all claims, suits, costs of investigations, costs of defense, settlements or judgments against them on account of an act or omission in the scope of the commissioner's or agent's duties or employee's employment. The commission shall refuse to indemnify if it determines that the act or failure to act was because of actual fraud, willful misconduct or actual malice.

d. Take such action as is necessary to prevent and avoid the payment of improper claims against the commission or the coverage provided by or through the commission;

e. Employ a general manager, who shall serve at its pleasure and be responsible for the conduct of the administrative affairs of the commission. The commission may employ other necessary personnel, including attorneys, actuaries, claims personnel, investment managers, secretaries and clerks, and may delegate to the general manager and other personnel such authority as it deems necessary to assure proper administration and operation of the commission. The general manager and the other personnel employed by the commission shall not be subject to the provisions of Title 11 of the Revised Statutes;

f. Hear and determine complaints of any member **[**unit of government**]** ***public entity*** concerning the operation of the commission;

g. Invest the moneys collected by or available to it in accordance with its liabilities and the statutory limitations on insurance investments in Title 17 of the Revised Statutes; **[**and**]**

h. Underwrite liability coverage, with or without a deductible, for nonprofit groups and their officers and employees whose assessment or premium for that coverage is guaranteed by a public

entity or the State ***if comparable coverage is otherwise unavailable at a cost of 120% or less of that charged by the commission*****. *For the purposes of this act, a "nonprofit group" is any corporation, association, trust or community chest, fund or foundation, organized exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals, or as a volunteer fire company, rescue, ambulance, first aid or emergency company or squad, and an association of parents and teachers of an elementary or secondary public or private school, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in, including the publishing or distributing of statements, any political campaign on behalf of any candidate for public office. For purposes of this act, any nonprofit group that is insured by the commission shall be a member thereof;*

*i. Underwrite liability coverage, with or without a deductible, for asbestos removal contractors who are licensed and their employees who have permits pursuant to P. L. 1984, c. 173 (C. 34:5A-32 et seq.). Any asbestos removal contractor who is insured by the commission shall be a member thereof; and**

[h.**]*** ***j.*** Take such other action as is necessary to effectuate the purposes of this act.

4. ***(New section)*** The commissioners shall adopt bylaws for the New Jersey Intergovernmental Excess Liability ***[**Fund**]*** ****Commission and its fund****. The bylaws shall include, but not be limited to:

a. Procedures for the organization and administration of the commission;

b. Procedures for the assessment of members for their contributions to the fund and for the collection of contributions in default. No later than December 1st of each year, the commissioners shall certify each member's assessment for the upcoming calendar year. This assessment shall consist of each member's share of the commission's budget for the upcoming calendar year, plus or minus as the case may be, any additional assessments or dividends from claims incurred during previous calendar years. The assessment for a calendar year, shall be pro rata based on each member's standard liability premium. Additional assessments or dividends shall also be pro rata based on each member's standard

premium for the year in which the claims were incurred. The commissioners shall prepare or cause to be prepared, a formula to calculate the standard liability premium based on exposure, compliance with regulations of the Department of Environmental Protection and actual claims experience;

c. Procedures for the maintenance and administration of appropriate reserves in accordance with sound actuarial principles. No later than December 1st of each year, the commissioners shall adopt a budget for the upcoming calendar year. This budget shall include an amount based on an actuarial estimate of the total ultimate cost of all claims which will be incurred by the commission during the upcoming year. By December 1st of each year, the commissioners shall compare the actual amount of claims incurred, plus an actuarial estimate of claims incurred but not reported, and shall determine if an additional assessment, or dividend, is necessary so that the ultimate expected cost of all incurred claims is fully funded. The commissioners may spread unusually large additional assessments over a period not to exceed three years;

d. Procedures for the purchase of commercial direct insurance or reinsurance, if any;

e. Procedures governing loss adjustment and legal fees;

f. Procedures under which a member *[unit of government]* *public entity* can extend coverage to a contractor performing work for the member *[unit]*; *[and]*

g. Procedures for the establishment of underwriting standards for nonprofit groups and asbestos removal contractors and their employees; and

[g.] *h.* Such other procedures and plans as the Commissioner of Insurance may require by rule and regulation.

5. *(New section)* The commissioners shall prepare, or cause to be prepared, a plan of risk management for the commission. The plan shall include, but not be limited to:

a. The amount of risk to be retained by the commission;

b. The amount of reserves to be established;

c. The proposed method of assessing contributions to be paid by each member;

d. Procedures governing loss adjustment and legal fees;

e. Coverage to be purchased from a commercial insurer if any;

f. Reinsurance to be purchased, if any, and the amount of premium therefor;

g. Such other procedures and information as the Commissioner of Insurance may require by rule or regulation.

6. *(New section)* The commission shall not begin providing insurance coverage to its *[member units of government]* *members* until its bylaws and plan of risk management have been approved as hereinafter provided:

a. The commissioners shall file with the Commissioner of Insurance for his approval a copy of the commissioner's bylaws adopted pursuant to section 4 of this act and a copy of the commission's plan of risk management prepared pursuant to section 5 of this act.

b. Within 30 working days of receipt, the Commissioner of Insurance shall either approve or disapprove the bylaws or plan of risk management.

If the Commissioner of Insurance shall fail to either approve or disapprove the bylaws or plan of risk management within that 30 working day period, the bylaws or plan shall be deemed approved.

If any bylaws or plan shall be disapproved, the Commissioner of Insurance shall set forth in writing the reasons for disapproval. Upon the receipt of the notice of disapproval, the commissioners may request a hearing. The hearing shall be convened by the Commissioner of Insurance in a timely manner.

7. *(New section)* Upon the approval of its bylaws and plan of risk management pursuant to the provisions of section 6 of this act, the New Jersey Intergovernmental Excess Liability Commission, may provide insurance coverage to its *[member units]* *members* by self-insurance, the purchase of commercial insurance or reinsurance, or any combination thereof.

8. *(New section)* The commissioners may, from time to time, amend the bylaws and plan of risk management of the commission; provided, however, that no such amendment shall take effect until approved by the Commissioner of Insurance as provided for in section 6 of this act.

9. *(New section)* The Commissioner of Insurance shall have the authority to assume control of the commission or to direct or take any action he may deem necessary, for good cause, to enable the commission to meet its obligations, cover its expected losses or to rehabilitate or otherwise modify its affairs. Such action shall be taken by the Commissioner of Insurance in the event of:

a. A failure to comply with the rules and regulations promulgated by the Commissioner of Insurance or with any of the provisions of this act;

b. A failure to comply with a lawful order of the Commissioner of Insurance; or

c. A deterioration of the financial condition of the commission to the extent that it causes an adverse effect upon the ability of the commission to pay expected losses.

10. *(New section)* The Commissioner of Insurance may, in his discretion, require the commissioners to file copies of any agreements or contracts entered into by the commissioners, or any other pertinent documents as he may deem necessary.

11. *(New section)* The commissioners shall cause an annual audit to be conducted by an independent certified public accountant in accordance with the rules and regulations promulgated by the Commissioner of Insurance pursuant to section 14 of this act. Copies of every audit shall be submitted to the Commissioner of Insurance within 30 working days of its completion.

12. *(New section)* The Commissioner of Insurance may conduct such examinations of the commission as he deems necessary. The expense of any such examination shall be borne by the commission.

13. *(New section)*The commission established pursuant to the provisions of this act is not an insurance company, and the authorized activities of the commission do not constitute the transaction of insurance nor doing an insurance business. The commission established pursuant to this act shall not be subject to the provisions of Subtitle 3 of Title 17 of the Revised Statutes.

14. *(New section)* No later than May 1, 1986 the Commissioner of Insurance shall promulgate rules and regulations pursuant to the "Aministrative Procedure Act." P. L. 1968, c. 410 (C. 52:14B-1 et seq.), to effectuate the purposes of this act. Such rules and regulations shall include, but not be limited to, the establishment, operation and modification of the commission established pursuant to the provisions of this act.

*15. N. J. S. 59:9-2 is amended to read as follows:

59:9-2. Interest and limitations on judgments. a. No interest shall accrue prior to the entry of judgment against a public entity or public employee.

b. No judgment shall be granted against a public entity or public employee on the basis of strict liability, implied warranty or products liability.

c. No punitive or exemplary damages shall be awarded against a public entity.

d. *(1)* No damages shall be awarded against a public entity or public employee for pain and suffering resulting from any injury; provided, however, that [this] *the* limitation on the recovery of

damages for pain and suffering *in this paragraph* shall not apply in cases of permanent loss of a bodily function, permanent disfigurement or dismemberment where the medical treatment expenses are in excess of $1,000.00. For purposes of this section medical treatment expenses are defined as the reasonable value of services rendered for necessary surgical, medical and dental treatment of the claimant for such injury, sickness or disease, including prosthetic devices and ambulance, hospital or professional nursing service.

(2) No public entity or public employee shall be liable to pay an award in excess of $500,000.00 for pain and suffering resulting from an injury to any one individual. If the award for damages for pain and suffering resulting from an injury to any one individual exceeds $500,000.00, the plaintiff may file a claim for that excess with the Appropriations Committee of each house of the Legislature. The claim shall be filed within one year of the final judgment of any action commenced pursuant to the provisions of the "New Jersey Tort Claims Act," N. J. S. 59:1-1 et seq. The Appropriations Committee of each house, or subcommittees thereof, or a joint committee thereof shall consider and report to the Legislature, within two years of the filing, whether or not a claim should be paid from the General Fund and in what amount, and the Legislature may make an appropriation therefor.

e. If a claimant receives or is entitled to receive benefits for the injuries allegedly incurred from a policy or policies of insurance or any other source other than a joint tortfeasor, such benefits shall be disclosed to the court and the amount thereof which duplicates any benefit contained in the award shall be deducted from any award against a public entity or public employee recovered by such claimant; provided, however, that nothing in this provision shall be construed to limit the rights of a beneficiary under a life insurance policy. No insurer or other person shall be entitled to bring an action under a subrogation provision in an insurance contract against a public entity or public employee.*

[15.] *16.* This act shall take effect immediately.

INSURANCE—PROPERTY AND CASUALTY

Establishes the New Jersey Intergovernmental Excess Liability Commission to insure certain public entities against certain liability claims within certain limits.

SENATE LABOR, INDUSTRY AND PROFESSIONS COMMITTEE

STATEMENT TO

SENATE, No. 1718

with Senate committee amendments

STATE OF NEW JERSEY

DATED: APRIL 28, 1986

This bill establishes the New Jersey Intergovernmental Excess Liability Commission to provide certain liability coverages to certain public entities.

Membership in this commission would be mandatory for most public entities, including counties, municipalities, utility commissions, and school districts, but excluding the State, State commissions and State authorities. However, if a public entity can secure comparable coverage for less money elsewhere, it may do so.

The commission would provide liability coverage for all claims in excess of $500,000.00 per occurrence, including general liability, automobile liability, police professional liability, public officials liabilty, environmental impairment liability, and other liability, with certain exceptions. The commission would be responsible for no more than $20,000,000.00, excluding defense costs, for liability claims arising from a single event. Each member of the commission may purchase insurance, self-insure or form a joint insurance fund to pay for its liability under $500,000.00 and over $20,000,000.00 per covered event.

The New Jersey Intergovernmental Excess Liability Commission would be organized as a risk sharing mechanism. The standard liability premium would be computed for each member according to its risk exposure. Before the beginning of the year, the total cost of all excess claims which will be incurred during the year would be estimated. The estimated claims cost plus expenses would be divided among the members based on each member's standard premium. At the end of the year, the actual claims experience plus reserves for open claims and claims incurred but not reported would be compared to the original assessment. If these claims are more than were originally estimated, each member would pay an additional pro rata assessment based on their original assessment: if they are less, a dividend could be declared.

New Jersey State Library

The commission would also have the authority to underwrite liability coverage for nonprofit groups and asbestos removal contractors according to underwriting standards established by the commission.

The commission would be required to adopt bylaws which would cover the procedures for the organization and administration of the commission: for the assessment of members for their contributions to the fund and for the collection of contributions in default; for the maintenance and administration of appropriate reserves; for purchasing insurance or reinsurance; and for loss adjustment expenses and legal fees. The commission would also be required to prepare a plan of risk management covering the amount of risk to be retained by the commission; the amount of reserves to be established; the method of assessing contributions from members; and the amount of insurance or reinsurance that should be purchased.

The commission would not be allowed to provide insurance coverage for its members until its bylaws and plan of risk management were approved by the Commissioner of Insurance. Also, any amendment to the bylaws or plan of risk management must be approved by the Commissioner of Insurance.

Under the provisions of the bill, the Commissioner of Insurance may assume, for good cause, control of the commission to enable it to meet its obligations, to cover its expected losses or to rehabilitate it.

The commission would be required to have an annual audit conducted by an independent certified public accountant. The audit report would be required to be submitted to the Commissioner of Insurance. The Commissioner of Insurance would also be able to conduct examinations of the commission as he deems necessary. The expense of these examinations would be borne by the commission.

The nine-member commission would be composed of the Commissioner of Insurance, two employees or officials of municipalities, two public members, one of whom shall have experience in insurance risk management, an insurance agent, and an employee or official of each of the following: a county, utility commission, and board of education.

The committee also added a provision which amends the "New Jersey Tort Claims Act" to place a $500,000.00 cap on the liability of a public entity for a pain and suffering award for injury to any one individual, but to allow the plaintiff to file a claim with the Appropriations Committee of each house for any amount of the award in excess of $500,000.00. The claim must be filed within one year of the final judgment and the Appropriations Committee must consider and report within two years of the filing, whether or not a claim should be paid from the General Fund and in what amount.

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Hearing transcribed by J & J Court Transcribers

SENATOR RAYMOND LESNIAK (Chairman): We're ready to commence the public hearing today. All of the other members of the Committee have excuses -- they have legitimate excuses and I won't dock them any pay for not being here today. But they will, of course, read the transcripts of today's hearings and any subsequent hearings we have specifically on the bill that I've sponsored, S-1718, which establishes the New Jersey Intergovernmental Excess Liability Commission to insure certain units of government against certain liability claims within certain limits.

However, obviously your comments are not limited to this particular bill, but, in fact, the issue. I think every member of this Committee is open to any comments and suggestions that you may have on the issue, and we're not limited to this bill and are certainly open to any suggestion for improvements or additional remedies, or no remedy if you think that that, in fact, is an alternative.

First we'll hear from the still Commissioner of Insurance, Hazel Gluck.

COMMISSIONER H A Z E L F R A N K G L U C K: Thank you very much, Senator. First, just let me say to you on behalf of the Department that we are very grateful for your continuing interest in this problem, in trying to help resolve a situation that is really out of hand, not only here but all across the country.

The current liability crisis has affected all of us, but it has been especially severe to municipalities, school boards and other governmental entities. This crisis is now impacting the very ability of government to deliver basic public services.

A recent study conducted by the League of Municipalities found that while most towns had primary liability coverage -- in other words coverage which pays the first 500,000 or so of a claim -- 47% of the responding communities lack excess or umbrella liability protection. It is just a matter of time, in our opinion, until one of these municipalities experiences a large, uninsured claim and is forced to enact a huge bond issue

to pay the judgment. This will have a devastating effect on the taxes and services of any community which is caught by this game of excess liability Russian roulette.

The municipalities which have been able to keep their excess policies, report substantially reduced limits and numerous new exclusions, such as pollution, asbestos, and child abuse. The cost for this grossly inadequate coverage has increased sharply and now averages $5.86 per resident. At this rate, if every town were to purchase an excess policy, the premium is estimated to be a staggering 42 million per year and the coverage would be seriously deficient.

The counties, authorities and school boards report similar problems. In fact, school boards throughout the State have contacted us in recent weeks fearful that when their policies renew in January they will receive the same treatment the municipalities received in their January renewals. Did I say January? I mean in July. July -- School boards come due in July.

What is the cause of this mess? If you listen to the insurance carriers, they blame the crisis on escalating claims, expansive court decisions, and inadequate premiums. However, in order to really understand the problem, the League of Municipalities and the Department tried to identify the actual excess liability experience of New Jersey municipalities over the last six years and this is what we found:

1) In a survey with half of the towns reporting, only three claims in excess of $500,000 paid or reserved were identified since 1980. These claims were the 5.5 million dollar Jackson Township case with which we're all familiar, another claim for a million and a.half, and a third claim for one million.

SENATOR LESNIAK: Claim, Commissioner, or actual paid?

COMMISSIONER GLUCK: Claim.

SENATOR LESNIAK: Okay.

COMMISSIONER GLUCK: 2) A company which insures

approximately a quarter of the State's communities and school boards was asked to review its records. They reported no claims paid or reserved in excess of $500,000 in the last six years.

3) A second company, which is the major underwriter of umbrella policies in this State was also asked to search its records. The result was actually the same: no claims activity over $500,000.

If you add all the claims together, the amount paid or reserved by umbrella or excess carriers, averaged only 1.5 million per year, including the Jackson Township pollution case. That case would now be excluded under the policies being issued by the industry.

Obviously there might have been a few cases we were unable to identify, but nothing of any real magnitude, we think, and certainly less than the value of the Jackson Township case.

So we must ask ourselves whether the insurance industry has fairly and efficiently met the needs of New Jersey's governmental units. Considering the actual claims experience, is approximately 42 million per year a fair premium? Is the industry offering the excess liability needed by local government to protect the taxpayers? The answers are clearly, no.

I don't believe that this is a manufactured crisis. Rather the problem is that underwriters lack the information they need to make sound underwriting decisions. They don't know the real experience of New Jersey municipalities. They act on perceptions and fear of the unknown rather than the facts. Another problem is that the reinsurance market collapsed last July, and there has been a general sense of panic ever since. Simply put, the underwriting system is out of control and is causing immeasurable harm to many segments of our society.

I think it is time for us to recognize that the insurance industry is incapable of solving our risk management problems for us. We in government are responsible for the risk management needs of governmental units. The insurance industry has already told us that they can no longer handle pollution

liability, and I accept their representation. It's obvious from the facts that they can't handle the other liability needs of governmental units, at least not in the current state of the insurance market. Therefore, it is our responsibility to put together an alternative that will protect local governments and will save the taxpayers the millions of dollars now being wasted on policies which fail to provide sufficient coverage.

To solve this crisis we need a package which in our estimation includes:

1) Tort reform

2) A cap on judgments against governmental units, and

3) An intergovernmental excess liability fund such as you have proposed.

First, tort reform -- I strongly believe that government should be responsible for paying for its negligence, but it should not be responsible for paying for the negligence of others. Therefore concepts such as joint and several liability are not appropriate for governmental entities.

Since it is the responsibility of government to respond whenever there is a serious accident, government cannot help but to become involved in all sorts of difficult situations. As you know, under today's law if government is found only one percent liable it can end up paying 100% of a claim if the other parties lack insurance or assets. In my view that is unfair, especially when taxpayers' money is involved.

The judgment cap -- the second thing we need is a cap on judgments. An award against a governmental unit is, in fact, an appropriation of public funds. I don't know of any other place where we give a blank check on the public treasury. This is a very serious problem considering the potential magnitude of claims against governmental units. For example, we have just started identifying our toxic waste problems. The risk is enormous, and it must be controlled.

I feel very strongly that government should fairly compensate those people who have been injured by the negligence

of government. This crisis should not be solved at the expense of innocent victims. However, states such as Florida, which have had a judgment cap for 15 years have been very successful in establishing a system where the legislature awards additional compensation in those instances where the injuries warrant it. This is a good balance between the need to be fair to injured people while making sure that the public's money is protected from excessive and undo awards. This is a check and balance which is sorely needed. There is a strong logic for having the Legislature, not the courts, make the final decision in large liability matters affecting public entities.

However, we must clearly understand that no cap is bullet proof. The cap applies separately to each individual governing entity. The problem is that each municipality is, in fact, a number of separate entities. For example, while the town usually maintains the ball field, a quasi-public athletic association often runs the Little League and similar programs. Frequently a town includes the athletic association as an additional insured on their policies. Because the athletic association is a separate entity, the cap is stacked in Little League type suits. The same problem exists with many ambulance corps, volunteer fire associations -- as opposed to a municipal fire department -- historical associations, and so on.

Another question is the status of radio corp and other multiple community services organized under the inter-local act. In many instances, a plaintiff will be able to collect a separate award from the inter-local agency, then one or all of the number communities based -- all of the member communities because the employees of an inter-local agency are often actually employed by one of the members of a town or one of the member towns. A suit against the agency which also names the employee will, in fact, trigger the policies of two or more separate entities -- the inter-local agency and the member community which employees the workers. A similar problem exists in road maintenance because frequently both the county and the municipality are involved in

maintaining the county roads. Many utility and swimming pool authorities, service only one community and while technically a separate entity, they are, in fact, a part of the municipal family. Furthermore, the cap will not protect the government units from suits filed in other states. Official vehicles cross state borders daily and many towns dump their garbage and their leaves in New York and Pennsylvania. Because of all these problems, municipalities will still need to purchase excess liability coverage over and above the awards cap.

SENATOR LESNIAK: Those leaves can be very dangerous.

COMMISSIONER GLUCK: Yes. Better, it should have said leavings.

Intergovernmental: Now, to the intergovernmental excess liability fund. As the current situation clearly demonstrates, the insurance industry is incapable of handling the liability risks of governmental entities in an efficient and comprehensive manner. Therefore a new mechanism is needed to finance the excess liability claims of the State's governmental entities. The proposed intergovernmental excess liability fund is based on the simple concept that government in this State is large enough to spread risks through pooling. To avoid adverse selection, the membership should include all units subject to Title 59 except the State itself. The program should have the following provisions:

1) Coverage: The fund should provide liability coverage for all claims in excess of $500,000 per occurrence including general liability, auto liability, police professional liability, public officials' liability, and environmental impairment liability. The intent is to provide a safety net so that large claims cannot slip through the cracks. The wording in the legislation should refer to all torts under Chapter 59 rather than the tort definitions used by the insurance industry.

2) Risk sharing structure: To prevent unfunded liabilities, the fund should be organized as a risk sharing mechanism. Under this structure: (A) the standard liability

premium is computed for each member. Members with little exposure will have a comparatively small premium while members with hazardous exposures or poor experience will have a comparatively higher premium. The fund should adopt a formula which takes into consideration exposure, compliance with DEP regs, and experience. (B) Before the beginning of each year the actuaries will estimate the total ultimate costs of all excess claims which will be incurred during the year. All accounting and coverage will be based on incurred claims rather than the claims made concept. The estimated claims cost plus expenses should be divided among the members based on each member's standard premium. (C) At the end of the year the actual claim experience plus reserves for open claims and IBNR will be compared to the original assessment. If this cost is more than originally estimated, each member will pay an additional assessment pro rata based on their original assessment. This additional assessment will be attached to next year's assessment so that it can be budgeted in advance for the municipalities. This retrospective adjustment calculation will be made each year until all claims are closed. If there's a surplus at the end of two years, it will be returned to the members as dividends against pro rata based on the original assessment. So it can go either way. It can be more. The money can be returned.

In short, total costs should be based on actual claims experience. Because of the annual adjustment mechanism the fund will always have sufficient funds to cover the costs of all open claims plus the actuarial estimate of IBNR and reserve development.

Administration: The fund's staff and overhead will be small because the fund will only get involved in the relatively few claims which exceed the $500,000 threshold. The fund may be able to operate with only one or two employees by contracting for many of the administrative services.

SENATOR LESNIAK: Commissioner, on that point--

COMMISSIONER GLUCK: Go ahead.

SENATOR LESNIAK: Won't there be additional staff needed to make the determination in terms of what each public entity will have to pay into the fund? It seems like --

COMMISSIONER GLUCK: There will be an actuary. That will be done on an actuarial basis. Now you could--

SENATOR LESNIAK: You contract for that service?

COMMISSIONER GLUCK: You can contract for that service or you can hire it, and you might be better off contracting.

SENATOR LESNIAK: Okay.

COMMISSIONER GLUCK: As long as you have a manager for the fund per se, things like that can be contracted out.

Safety: The program should be structured to motivate municipalities to improve safety practices in their operation. Any unit which reports an excess claim should have its assessments doubled until its loss ratio is below 100% again. The funds should require each unit to submit a yearly report listing all claims, the cause and the background. This will allow the fund to monitor claims experience, including adverse court trends. The fund will interface with other State departments to identify government units with excessive claim experience and promote programs to reduce this expense.

The advantage of this approach is obvious. While governmental units will still be free to determine their insurance programs for their primary coverage, they will be guaranteed excess coverage with no gaps or exclusions. This eliminates the most serious of the current problems, including the lack of pollution coverage, the confusing claims made policy, insurance company insolvency, and availability problems due to periodic market cycles.

The cost will be determined by actual claims expenses and will be dramatically less than commercial insurance. In other words, if the claims cost 1.5 million per year, the cost will be in that range depending upon administration and interest income. Considering the results of the recent claims survey, the municipalities alone will probably save at least 35 million per

year. Savings by other governmental units should increase the initial savings into the area of 50 million.

The fund will also permit the development of sound risk management. The State will be able to closely monitor claim trends and will be in a better position to advise the Legislature on the tort and safety reforms necessary to control losses. Furthermore, the fund will facilitate the formation of regional pools to administer claims below the $500,000 threshold. Pooling will encourage greater involvement by local officials and greater concern about preventing accidents.

However, I must emphasize that we will not support the fund without a judgment cap. The fund must not become another form of blank check on the public's money. We must have a better check and balance system to control court awards.

In conclusion, the current situation is totally unsatisfactory. The best the insurance industry can offer is excessive premiums, inadequate limits, and numerous exclusions such as pollution. The solution to these problems requires a bold approach, including tort reform, an awards cap, and the proposed excess liability fund.

It's critical that we act now. Every week of delay costs another million dollars in excessive premiums. That's a million dollars a week we don't have for such things that we really need such as text books and teachers' salaries and policemen, and road repairs, and other vital services.

SENATOR LESNIAK: Commissioner, when you say that you wouldn't support this without a judgment cap, you're not talking about a rigid judgment type, you're talking about some form of mechanism where the cap could be released when warranted, is that correct?

COMMISSIONER GLUCK: What do you mean by released when warranted?

SENATOR LESNIAK: Well, that it wouldn't be a rigid cap. It wouldn't be set at an arbitrary figure which could not be exceeded under some mechanism.

COMMISSIONER GLUCK: Well, we looked at this, Senator, and there were two ways that we thought it could be approached. One was that if we have a cap, any citizen that needed care beyond what that cap would offer could either go to the subcommittee, the Joint Appropriations Committee, which is a claims committee that I guess is little known, and have their matter adjudicated and the State would pay for it if the State, in fact, has the funds -- which is what they do now.

The second was the State of Florida that we looked at, which we thought had a very interesting concept and that was that the judiciary committee of each house hired themselves, on an as needed basis, I think, what they call a claims master. When the claims came in above the cap, they were looked at by the claims master, sent back with that person's recommendation to the judiciary committee. If all went well, it went straight to the legislature; it's usually approved because the claims master is obviously a professional that helps the legislature. And then the municipality is assessed, in that instance, whatever the final decision is and not the state. I think it is something worth looking at because now you're talking about elected public officials dealing with entities that are also elected by the public and it does take this kind of thing out of, as I said in my statement, out of the judiciary which may -- I mean, that may not--

SENATOR LESNIAK: Vagitudes of the jury system.

COMMISSIONER GLUCK: Yeah. I won't even go that far, but it does take it out, put it back in the elected officials' hands, and these public monies that we're talking about. We seemed -- We liked that when we looked at it and we think it bears looking into.

SENATOR LESNIAK: At the same time it doesn't have the cruel and inhuman aspect of a cap that's arbitrary and can't be released when warranted.

COMMISSIONER GLUCK: That's right. I agree with you.

SENATOR LESNIAK: Any questions from the Committee? (no

response) Thank you, Commissioner, very much. I appreciate it.

COMMISSIONER GLUCK: Thank you.

SENATOR LESNIAK: Bill Dressel from New Jersey State League of Municipalities. Bill, I always want to pronounce your name "Driesel" like the Maryland basketball coach, Lefty.

W I L L I A M G. D R E S S E L, J R.: Thank you, Mr. Chairman. My name is Bill Dressel. I am Assistant Executive Director of the New Jersey State League of Municipalities and I would like to thank you for the opportunity to offer testimony on Senate 1718, which establishes the New Jersey Inter-governmental Excess Liability Commission.

Senate 1718 is the product of an exhaustive study of the insurance liability crisis by the Environmental Liability Impairment Study Commission. The League of Municipalities was actively involved in the deliberations of that Commission. The concept of a statewide pool was, in fact, mentioned in our testimony of October 2nd and was discussed further in testimony presented by Mayor David Grubb of Park Ridge on October 14th.

We compliment the sponsors of Senate 1718 for taking the initiative to introduce this kind of legislation which calls for the restructuring of the insurance delivery system to local governmental entities. The present insurance dilemma is by far the most serious problem confronting municipalities at this time, and Senate 1718 will go a long way in addressing that problem.

Before I get into the specifics of this legislative proposal, let me briefly review the liability problem from the municipal perspective. This past July a League survey revealed that approximately 30% of the State's municipalities had considerable difficulty in getting insurance coverage. The communities which were fortunate to find a carrier who would insure them experienced unusually high premium increases at reduced levels of coverage.

On September 17, 1985 Governor Thomas H. Kean approved an emergency regulation to prohibit insurance companies from terminating entire lines of insurance coverage, imposing mid-term

premium increases or mid-term reductions in coverages for municipalities.

Our primary concern with this regulation has to do with the affordability issue. There is nothing in the regulation that prohibits an insurance carrier from quadrupling an insurance premium when the policy comes up for its mandatory renewal as set forth in regulation. This presented an extremely difficult situation for municipal officials who were confronted with the onerous task of putting together their '86 budgets. Many communities found that they would have to curtail vital service delivery programs or increase property taxes to pay insurance premiums.

The League, in the waning hours of the last legislative session, successfully got legislation enacted as Chapter 522 of the Public Laws of '85 which would place all insurance premium costs outside the spending cap. However, let me assure you that this action in no way represents a solution, but was a response to a legitimate budget concern that we hope does not have to be repeated in the future.

Early in the new year the League conducted another statewide survey in conjunction with the State Department of Insurance to assess the current condition of the market. We found that although most communities were successful in getting primary insurance coverage, their costs rose approximately 50% to 100% over 1985 premiums. The most severe problems we discovered, however, were at the umbrella or excess liability level. Approximately 47% of the municipalities lack excess liability coverage. The remaining communities experienced sharp increases in premiums between 200% to 1000%. If every community purchased an umbrella policy, the cost would be a staggering 42 million. Furthermore, most municipalities report significant reductions in coverage limits down to only one to three million in 1986 as compared to four to five million in 1985 with exclusions including such things as pollution and sexual abuse. According to the State Department of Insurance other governmental entities,

including school boards, counties, authorities, and the State itself report similar problems.

Our survey, which includes responses from one half of the State's municipalities found only three claims paid or reserved in excess of 500,000 in the last six years. They include Jackson Township for 5.5 million, the City of New Brunswick for 1.5 million, and Atlantic City for one million. It is also important to point out that Selected Risks Insurance Company, which insures approximately one-quarter of the State's municipalities and school boards, have reported that they have not had a single claim paid or reserved over 500,000.

This data clearly suggests that the local government entities have not experienced many large claims to warrant excessive premiums and the collapse of the excess liability market.

The financial experts and economists identify two primary causes for the current insurance crisis. First, the insurance market is cyclical in nature, periodically undergoing wide swings in behavior. Government intervention is necessary to introduce greater stability in the market and to eliminate the extreme fluctuations. To date, neither the Federal government nor State government has undertaken such an effort.

Second, the recent expansion of tort liability has increased coverable losses and created great difficulty in predicting losses. Actions at the federal and state level are necessary to establish more certain ground rules and to clearly define and limit the circumstances in which a governmental entity should be considered financial liable for its actions.

Let me assure you that our insurance problems are not singularly related to municipal risk management practice here in New Jersey. To the contrary, it is a national problem that is plaguing all levels of government.

In short, the reasons for our State's insurance woes are, by in large, attributed to the landfill pollution case involving Jackson Township. The exorbitant amount of that legal

award sent shock waves throughout the insurance industry, resulting in companies pulling out of the municipal insurance market fearing the higher risks.

Our legislative solution: The insurance crisis is attributable to a number of recent developments in the insurance industry and in the American legal system. The only legislative approach which will work is a multi-faceted attack on the problem. The League supports two legislative approaches.

1) The establishment of the Inter-governmental Excess Liability Fund as provided in the legislation before you as Senate 1718. This legislation will provide excess liability for all governmental entities in excess of 500,000 per claim up to a maximum of 20 million. This kind of funding mechanism will not only offer public entities excess liability levels, but we are certain that it will also address the affordability issue as well.

It is important to point out that the industry is not presently writing all of the liability coverages found in Title 59, i.e. pollution and sexual abuse, that would be available under Senate 1718. All of us recognize the fact that local governments have considerable exposures that would or that could potentially result in a large liability claim. Senate 1718 will serve as a safety net to cover those kinds of claims. We also believe the existence of such a system will bring about more stability in the insurance marketplace by stimulating more competition in the industry for primary coverages up to the first 500,000 which will result in a more realistic pricing system.

Once excess coverages are made available, self-insurance pooling will become more prevalent as a means of managing municipal insurance costs. Joint self-insurance pooling can be a cost-effective means of managing insurance costs. The reason there have not been the creation of more self-insurance pools -- presently there are two in Bergen County -- is due to the obvious lack of excess liability coverage by the industry.

We would like to make two recommendations to Senate 1718

that we believe would enhance this proposal.

1) That there be a mandatory review and assessment of the Commission's experience done every three years by the State Department of Insurance. We would also suggest that the State Department of Insurance conduct a public hearing on their findings. Any final determination as to whether or not the fund should be abolished or continued be made by the Legislature.

2) Local government entities which can get comparable coverages and terms as set forth in Senate 1718 from other sources than the fund should have the option to withdraw. A provision of this nature would allow local governments greater flexibility in meeting their insurance needs.

Two, our second legislative approach in addressing -- is to address tort reform. Tort reform is certainly needed as a part of any solution to this crisis. The League supports the administration's proposal of capping the amount a plaintiff would recover from a municipality under the Tort Claims Act. We have not seen this proposal yet, Mr. Chairman, but we understand the administration is talking about a cap of $250,000 per person and one million per occurrence.

SENATOR LESNIAK: I think it's been boosted up to 500,000. They got a little--

MR. DRESSEL: That's what rumor has--

SENATOR LESNIAK: A little more sense creeped into the--

MR. DRESSEL: We also support other proposals like Senate 150 sponsored by Senator Foran, which would limit the liability of a municipality when a judgment is awarded, to the percent of negligence determined. The current pattern is to sue everybody, including the municipality, knowing that if the individual does not have adequate insurance the municipality more than likely does.

In conclusion, consumer organizations claim that the current crisis is manufactured by the insurance industry to increase profits and reduce victim's rights. The insurance industry blames a decade of price wars and two decades of

increased litigation for the current crisis. The reason for the current crisis at the municipal level has nothing to do with the loss experience of the particular government that is hit with an enormous increase in insurance costs or the cancellation of its insurance policy. Rather, the industry appears to have decided that all municipalities are bad risks.

We believe Senate 1718 will go a long way in bringing about a permanent solution to this crisis and we urge you to act favorably on it. I thank you for this opportunity to present our concerns. I'll be glad to answer any questions that you may have.

SENATOR LESNIAK: Thank you for your testimony, Bill, and thank you for your help on the Environmental and General Liability Commission as well.

MR. DRESSEL: Thank you.

SENATOR LESNIAK: William Rue, National Legislative Affairs Chairman for the Professional Insurance Agents. Mr. Rue?

W I L L I A M R U E: Good morning.

SENATOR LESNIAK: (referring to speaker's written testimony) Do you have an extra copy of that?

MR. RUE: Thank you for the opportunity to address this Committee regarding Senate Bill 1718 and the liability problem facing the State of New Jersey.

My name is William Rue and I am testifying on behalf of the Professional Insurance Agents of New Jersey, a statewide association which represents 1,300 independent insurance agencies with more than 8,000 agents and employees primarily engaged in the sale of property and casualty insurance.

I am a director of the National Association of the Professional Insurance Agents and I serve as its governmental affairs chairman. I also am past president of Professional Insurance Agents of New Jersey and I'm president of a professional insurance agency which is located here in Trenton. We insure approximately 10,000 policyholders, both in the personal and business sector of the economy.

Having the technical ability to provide insureds with professional insurance advice, not being an insurance company, and understanding the liability insurance problems faced by many insureds today, the perceptions of the professional insurance agents reflect interactions and familiarity with the problem in a uniquely informed way.

Liability problems of today have been caused by substantial changes in the American tort liability system. Simply put, we have moved from a fault-based system aimed at restitution for damages to an alternative mechanism for compensation. While insurance readily available at very reasonable premiums fueled this trend over the past few years, the industry finds itself no longer able to do so.

Tort law has changed significantly, particularly in the concepts of fault and proof. Starting with the asbestos cases of the '70s, toxic waste and the Agent Orange cases, State and Federal courts have effectively replaced the necessity of a causal connection between activity and the injured party with the concept of joint and several liability. Following this line of thinking, when an injury occurs, but individual liability is not established, it is presumed that all parties are fully liable.

SENATOR LESNIAK: I think we have to stop right there.

MR. RUE: Okay.

SENATOR LESNIAK: Whose law is this?

MR. RUE: I'm sorry?

SENATOR LESNIAK: Is this on another planet?

MR. RUE: No.

SENATOR LESNIAK: Because it's certainly not here in the State of New Jersey. Can you show me one case where it's presumed that all parties are fully liable? Can you show me one case where you don't have to establish a causal connection between the activity and the injury? I would like you to provide that for me because if that's so, I should throw out all the training that I've had in law.

MR. RUE: Well, I think what we're saying here is the

joint and several certainly is being quite applicable--

SENATOR LESNIAK: The joint and several has absolutely nothing to do with probable cause, does it?

MR. RUE: Okay, I--

SENATOR LESNIAK: I think you're missing the two concepts, but go ahead.

MR. RUE: This concept has become the thought process for massive tort and latent liability cases such as the approximate $6 million Jackson Township case. In addition, the burden of proof used to be on the plaintiff. Today that burden is increasingly borne by the defendant.

SENATOR LESNIAK: Okay. I have to stop you again there.

MR. RUE: Okay.

SENATOR LESNIAK: Give me one case.

MR. RUE: Well, I guess it's a matter of perception.

SENATOR LESNIAK: Okay, not of fact. Go ahead.

MR. RUE: Courts are increasingly using -- it has been most recently reported that local governments incur about one billion dollars annual in defense costs, with a record number being threatened by bankruptcy.

There are three developments that have contributed significantly to the cost of civil justice. First, damages for pain and suffering, different from compensatory damages for economic loss, have risen substantially.

Second, punitive or exemplary damages awards punish defendants for acts of malice or gross negligence have increased dramatically in amount and number. And thirdly, attorney's fees have grown at a phenomenal rate.

For example, it has been reported that in the 1950s legal defense accounted for five cents of every insurance premium dollar. In 1983 legal defense accounted for 25 cents of every insurance dollar. Currently it is estimated that the cost has risen to approximately 33 cents of every insurance premium dollar. Regarding products liability claims, for every 66 cents received by claimants 77 cents is paid out in legal fees.

SENATOR LESNIAK: Can you give me the source of that information?

MR. RUE: Yeah. I have all the sources of the information in the back of the testimony.

SENATOR LESNIAK: I'm interested in the source of that particular--

MR. RUE: I'm sorry. We have the sources of all--

UNIDENTIFIED SPEAKER FROM AUDIENCE: I'll get you that. That page was omitted. Sorry about that.

MR. RUE: We do have that.

Here are some additional -- and most of these facts that I am going to -- speak of -- we do have the documented source on those and we will provide them. Here are some additional interesting and pertinent statistical information. In 1984 one private lawsuit was filed for every 15 Americans. In 1962 the first million dollar verdict was handed down. In 1982 the number rose to 251, and in 1983 it rose to 360. That's 360 lawsuits in excess of one million dollars. In 1984 the average products award equaled 1.7 million, the average medical malpractice award equaled $950,000. Since 1950 the number of civil trials in Federal courts that lasted greater than 20 days has increased more than 1,000%.

SENATOR LESNIAK: These are general statistics, not -- regarding the entire tort liability system.

MR. RUE: That's correct.

SENATOR LESNIAK: Not as they apply to public entities.

MR. RUE: That's correct. That's right.

In a recent case history an expert gymnast was awarded 14.7 million dollars against the manufacturer of the mat. Another jury awarded $804,000 against the Corning Company because the company failed to warn the owner that the dishes might fall and shatter if stacked, to warn the owner that the -- excuse me, five deep, with their lids inverted in the kitchen cabinet. Kentucky's Senator Mitch McConnell stated that the theory in the gymnast case was that the manufacturer failed to warn the gymnast

of the potential danger in doing one and a half rolled flips onto a mat which was 18 inches thick.

SENATOR LESNIAK: You're going to have to excuse me, but I would rather read the case than hear Kentucky Senator Mitch McConnel's statement on it.

MR. RUE: Okay. We can -- okay. We can provide that.

SENATOR LESNIAK: Okay.

MR. RUE: Roughly two million cases are filed every year in state courts. Civil filings in Federal courts are up from 67,000 in '65 to 274,000 in 1985. However, 57,000 suits were brought by the government regarding defaulted loans and over payments.

A recent Rand Corporation sample of 9,000 jury awards found that when the defendant was a corporation the average award was 161,000. When it was the government, the average was $98,000 but when it was an individual it was $37,000.

Aggravating the tort liability system and leading to the current problems of availability and affordability of insurance is the court interpretation of insurance policies. To be more specific, courts have interpreted standard policy language in ways never intended by the insurance company underwriters. The impact on liability insurance pricing and availability is clear. A basic fundamental of the concept of insurance is the ability to predict. The results of typical damage cases, such as the Jackson Township case, made predictability impossible. It destroys the rationale of the concept of insurance.

The Jackson Township case that you hear so much about did the following. Insurance policies were interpreted by the courts to provide gradual pollution coverage when the intent was to provide sudden and accidental coverage. An occurrence was considered a continual exposure rather than a specific event and finally, policy limits were applied to each part of the occurrence, thereby stacking liability limits and creating unlimited liabilities. Predictability was destroyed. Policy language agreed to by insurance company drafters and

policyholders no longer applied. Exposure could no longer be calculated or priced given this court's action. And this action retroactively affects hundreds of thousands of policies dating back many years.

Lloyds of London's chairman, Peter Miller, said, I quote, "Nobody should complain about a system if that system can tell him clearly what liabilities they face. But the way matters have transpired in the United States means that the American legal system does not do that."

Having broadly addressed the problem, the next pertinent question is what has happened? First, it is important to note that there is much activity beginning on both the state and national level.

Since the law is largely a state matter, events on this level are extremely significant. Through 1985, 42 states have introduced a total of 264 bills relating to liability insurance.

SENATOR LESNIAK: I think we have that many just here in New Jersey alone.

MR. RUE: Could well be, Senator. 47 were enacted into law in 28 states and of the 47, 21 relate to civil justice reform. For example, in California a Fair Responsibility Act will be on the statewide ballot. The act intends to revise joint and several liability to apply only to actual, direct economic loss, not pain and suffering. Washington is seeking to pass a law like the one in California which limits attorney fees in malpractice, and pain and suffering awards to a quarter of a million dollars. Michigan, Nevada, Oregon, Montana, and Alaska have similar type activity going on.

In Georgia, 50 state trade and industry organizations are focusing on state legislative tort reform as a group. Illinois is following a similar approach with 30 organizations involved. Other states with similar activities include Texas, New York, Indiana, Pennsylvania, Florida, Louisiana, and Kansas.

As a member of the Professional Insurance Agents of New Jersey legislative team visiting Washington, D. C. this week, I

learned that President Reagan has set up in the Office of the Attorney General a tort policy working group with eight task forces to examine the tort system and its effect on cost and availability of commercial insurance, and to recommend possible changes.

SENATOR LESNIAK: Can I suggest something there that--

MR. RUE: Sure.

SENATOR LESNIAK: -- if anybody gets on that working group of President Reagan, the best thing to cut down the cost of environmental impairment insurance and to make it available is to provide enough monies to clean up hazardous waste dump sites in this country. Do that and you're going to see a lot of--

MR. RUE: Well, yeah, the task forces that have been set up are, you know, staff task forces within the Attorney General's office.

SENATOR LESNIAK: Somebody should start talking about that as well. Okay.

MR. RUE: In visiting the various members of the New Jersey Congressional delegation we found a growing concern and involvement with the U. S. tort liability system and recognition that this problem, including the environmental liability issue which you just spoke about, transcends the issue of liability insurance and is, in fact, social in nature.

Legislative activity is definitely beginning to occur. The U. S. Supreme Court has begun issuing rulings of note. For example, it upheld an Indiana high court's prohibition of suits against health providers unless the claimant's case was first cited by a medical review panel. California's cap of attorney's fees was upheld as well.

SENATOR LESNIAK: We used to have a medical review panel in medical malpractice cases. It was discontinued by both sides, defense and plaintiff's side because it was felt to be really unnecessary expense and a needless procedure that really didn't help to resolve cases. So we did try that here in New Jersey and found it wanting.

MR. RUE: Okay. The American Tort Reform Association was recently created which consists of 24 businesses, professional, and governmental groups. It includes the American Medical Association, the American Trucking Association, and the American Society of Association Executives.

It should be noted, finally, that the New Jersey Insurance Task Force on Environmental Issues has recently completed an expansive report on environmental liability. Recently given to the printer, the report will include a summary of current legislation and regulation affecting environmental liability in New Jersey and discuss the important subjects of joint and several liability, of the negligence standard, and the state-of-the-art defense. Dealing with a major and immediate liability problem area, the report is expected to be ready for distribution soon.

Having restated the problem summarized current activity, the million dollar question is what do we do now? Clearly we must be careful to avoid quick fixes, Band-Aid type remedies that will not deal with the root causes of the liability problem, and in the long run only serve to exacerbate the situation.

Mandated pools, for example, an alternative risk-bearing mechanism, in and of themselves do nothing to alleviate the problems being faced today. An excellent example is the medical insurance crisis in New York that led to a JUA/reciprocal mechanism thought by some to resolve the problem. Because of the long tail regarding liability claims it took several years for New York to realize the root causes of the medical insurance crisis was not dealt with, therefore the mechanism did not work. New York's Medical Malpractice JUA is $535,924,000 in the red as of the last actual figures available. It is estimated that figure has risen to approximately 800 million.

SENATOR LESNIAK: Can I-- Is that an excess liability fund or does that also include primary coverage?

MR. RUE: I believe that includes primary coverage.

New Jersey's Medical Malpractice JUA -- excuse me. New

Jersey's Medical Malpractice Plan is estimated to be $65 million in the red.

SENATOR LESNIAK: That, too, is primary coverage as well?

MR. RUE: I believe it is. All ten medical malpractice JUA plans in the United States are running in the red a total of $1,047,000,000 as of June 30. Also, the New Jersey Unsatisfied Claim and Judgment Fund is estimated to be 680 million in the red with an ultimate value estimated to be 800 million dollars.

Clearly the liability problems must be resolved regardless of the insurance, self-insurance, or pooling mechanism being utilized by businesses, professionals, manufacturers, or public entities. Incidentally, all of these alternatives are currently permissible under the New Jersey law. Having resolved the real problems all risk-bearing mechanism become viable alternatives, readily available at affordable prices.

We propose some specifics that we feel should be addressed in legislation. It is necessary as a first measure to set up a New Jersey market assistance program as has been done extensively across the United States. Such a MAP requires the active participation by the insurance industry to be sure that coverage can be provided where needed. The MAP should be available to groups where there is a critical need to fill an insurance void and should have the ability to be expanded to other groups as needed.

SENATOR LESNIAK: Let me ask you. Haven't we set that up? Is that set up in New Jersey?

MR. RUE: I'm not aware that it's set up in New Jersey at this point, no. I know there's been a lot of talk about it.

MR. DAVIS: I think we can wait. Hazel will make a response to that. I think she can clarify that for us.

SENATOR LESNIAK: Okay.

MR. RUE: Consideration should be given to amending New Jersey regulation in New Jersey as controls policy cancellations and coverages provided. Given some modifications the effect

could be some additional market availability and greater participation on a voluntary basis as a MAP.

Consideration should be given to the segregation of the pollution liability issue, which should be dealt with as the social issue it is in fact. Such an approach would make other liability insurance more affordable. I would speculate the liability premium reductions might reach as high as 25 to 30% or higher.

SENATOR LESNIAK: Again, hasn't the Department done that?

MR. RUE: There seems to be within the industry a great deal of question as to whether that has been done. I know in policies--

SENATOR LESNIAK: We'll ask the Commissioner when she comes back.

MR. RUE: The policies that are coming through that we have are not containing an exclusive like that.

Consideration should be given to the establishment of a mandatory arbitration system regarding small liability claims.

Legislation should be considered to do away with the doctrine of joint and several liability, replacing it with several liability only.

Consideration should be given to addressing legal court fees, such as sliding fee schedules, contingency fee reporting laws and disclosure.

SENATOR LESNIAK: Again, isn't that in our court rules?

MR. RUE: Disclosure, yes.

SENATOR LESNIAK: Aren't there-- Isn't there a sliding fee schedule and isn't there a disclosure requirement in the court rules?

MR. RUE: Yes. Consideration should be given to limitations on pain and suffering damages in terms of caps, standards, or both.

Consideration should be given to the abolition of regulation of punitive damages.

Given the fact that this issue impacts not just municipalities, schools boards, or insurance companies, but product manufacturers, truckers, professionals, and more, I suggest consideration be given to the formation of a coalition of industries, perhaps through their trade associations, to deal with the issues, make their feelings known and most importantly, make recommendations.

Specifically regarding municipalities, consideration should be given to limiting liability and capping awards. The vehicle to do this already exists in Title 59 and it should be noted that 28 states have already done so.

Consider limiting -- eliminating or limiting a municipality's liability for damages which punish public entities for their conduct and procedures.

Consider the elimination of joint and several liability with respect to public entities.

Consider limited immunity for essential, high-risk activities of public entities such as waste disposal.

Consider the permission of juries to be advised of awards from other sources.

SENATOR LESNIAK: Do we really want to limit liability--

MR. RUE: We're offering a lot of considerations here.

SENATOR LESNIAK: Do we really want to do anything in terms of immunity when you're talking about environmental damage? Isn't that an incentive for proper action by municipalities? Wouldn't we be just, you know, opening up the gate to a very expensive and severe environmental pollution if we didn't have tort liability system in that area?

MR. RUE: I guess it would depend on how it was structured, but what we're suggesting is, I think, this crisis has become so critical that we just have to look at everything. We're not suggesting that this is the only solution.

SENATOR LESNIAK: Okay.

MR. RUE: Consider methods of encouraging public entity risk management which can reduce exposure, improve loss

experience, and lead to premium reduction.

We applaud Senator Lesniak's positive action in seeking a solution to the liability insurance problem, but are opposed to the mandatory concept of the pool. We are also concerned that the bill, in its present form, will mask identification of the real cause of the problem.

As stated earlier, we recognize the existence of pooling as a risk-bearing mechanism in addition to insurance and self-insurance, but suggest that none of them, including a standard pool, resolve that problem unless there is meaningful tort reform.

In summary, the focus should be on tort reform with emphasis on the public entity sector by necessity. If the broad-based coalition I referred to earlier is created, the insurance marketplace -- along with pooling and self-insurance -- will respond to tort reform and the consumers will have choices in obtaining affordable protection. The Professional Insurance Agents of New Jersey believe that this is the best direction and solution. We thank you for the opportunity to attend.

SENATOR LESNIAK: Thank you very much.

I'm going to call back, if she would, Commissioner Gluck to talk on two issues that Mr. Rue raised that we're interested in. That's the MAP program and the pollution exclusion.

COMMISSIONER GLUCK: Yes, sir. Okay.

SENATOR LESNIAK: There appears to be some dispute or at least we're not sure where we're at.

COMMISSIONER GLUCK: Pollution, I'll begin with the second one first.

SENATOR LESNIAK: Okay.

COMMISSIONER GLUCK: The pollution exclusion has been granted. Many of them were deemed by the Department before I got there that were granted. I have, in effect, granted pollution exclusion. The letter went out I guess about a week ago to everybody else who was waiting, aside from ISO, which we already said we would accept. So that's been granted.

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I don't know where the confusion lies. I think the industry knows that. They're writing with the exclusion. Even if they write with the exclusion for municipalities the prices are exorbitant, so even with the exclusions we are finding that the prices are sky-high. That's the first thing.

The MAP and replacement regulation: The replacement regulation appeared in "The New Jersey Register" on March 3rd. It is a replacement regulation that we negotiated with the industry over the past five months. It is contingent, the adoption of that is contingent on whether or not we get participation in a market assistance plan which we also negotiated with the industry, which is, I hope and I think, going to be better than most market assistance plans that have been promulgated in the rest of the country because it says in this plan that each insurer who participates must accept one out of every five good risks that are submitted to them. So all we're waiting for now, and I expect to have that information by the end of this week, maybe the beginning of next week, is for the companies who write the most liability insurance in this State to become part of this market assistance plan. We want 70 to 80% of the market represented in the market assistance plan so that they can help us place the good risks that are having a difficult time getting insurance. We will not adopt the regulation until we get the market assistance plan.

Now, why -- I mean, I thought everybody knew on that, but I thought that at least the PIA knew where we were on that. The announcement has not been made yet because we don't know about the participation. As soon as the participation is nailed down we will have an announcement to make.

SENATOR LESNIAK: There's a mechanism for the companies for getting off the risk if it is deemed to be or determined to be a bad risk once they're on it.

COMMISSIONER GLUCK: No. This is not a mechanism to get off the risk.

SENATOR LESNIAK: No, but what I'm saying is if they do

take the one in five, is there a mechanism for them to get out once that risk turns bad?

COMMISSIONER GLUCK: They keep it for a year. Like they would, you know, keep it under ordinary circumstances. And the--

SENATOR LESNIAK: But do they have to fear a regulation coming down from the Department that won't allow them to get off?

COMMISSIONER GLUCK: No, no, because we have negotiated the replacement regulation which does not say that in effect. Even though the emergency regulation said that, we said at the time that we adopted the emergency regulation that we did not want it to be permanent. Of course nobody ever believes a regulatory agency when they say that and I can understand why, but in this instance it will not be permanent because we will adopt the replacement regulation with the MAP.

What gave us the leverage to get some of the things we needed was the fact that we won all of our court cases all the way up.

SENATOR LESNIAK: And people said the income tax wasn't going to be permanent. (Laughter)

COMMISSIONER GLUCK: I know, but I wasn't one of them, thank God.

Let me just also say that the comparison, Senator, between the medical malpractice reinsurance association and this risk sharing mechanism -- it's not comparable; it's just not the same thing at all. One is a residual market mechanism and this is the risk sharing proposal that you're making is not a residual market mechanism, so they are not comparable in that sense.

SENATOR LESNIAK: Okay. Thank you, Commissioner.

COMMISSIONER GLUCK: Thank you.

SENATOR LESNIAK: We're going to hear now from Jerry Fischer, Deputy Attorney General, Section Chief of the Claims Section, Tort Claims.

J E R R Y F I S C H E R: Thank you, Senator. I'm not going to repeat here an analysis of the crisis that you've now heard for the last three hours.

SENATOR LESNIAK: Please spare, I've heard it for the last six months.

MR. FISCHER: I would say that the position of the Attorney General is that this particular legislation when taken in conjunction with tort reform legislation concerning the Tort Claims Act, is a very responsive bill to the insurance crisis that exists now. The Attorney General's position, though, is that this legislation should apply to local and county entities and not to the State of New Jersey.

SENATOR LESNIAK: So that's why the State is going to be on. Says that here. I think it was my proposal they were on. (Laughter) There's nobody here but us in this room.

MR. FISCHER: The Attorney General's view is that the State has a very comprehensive risk management program. It's a sufficiently large risk that it can develop its own funding mechanisms and has, since the inception of the Tort Claims Act. Our loss experience has never exceeded claims in the amount of one million dollars and we believe that, although our actuarial studies of State claims suggest some potential exposures in excess of $500,000, they are are exposures that can be best managed in the mechanism of the Tort Claims Fund as they have for the last 15 years or so.

However, our view of it is that the crisis exists not only because of the refusal of the insurance industry to write, but because of very severe underlying problems in tort law mechanisms. 1) Insurance policies are unavailable because there is a lack of predictability in terms of loss exposure at this time due to the rapid expansion of tort law in the courts and a rapid increase in the size of judgments and potential judgments. We think that this mechanism--

SENATOR LESNIAK: Doesn't the belie what you just said about the State's loss experience?

MR. FISCHER: Well, the insurance industry would look at the loss experience of government as a whole, not only in the State of New Jersey, but in the United States. The State is

sufficient large, the State of New Jersey itself--

SENATOR LESNIAK: That makes a lot of sense.

MR. FISCHER: -- is sufficiently large to be able to look at its own loss experience and distinguish it from the loss experience of government as a whole.

SENATOR LESNIAK: But the municipalities and public entities -- all of the public entities in the State of New Jersey -- are not sufficiently large enough to come out with some kind of experience rating?

MR. FISCHER: Well, as I -- I don't know exactly what the loss experience of local entities has been.

SENATOR LESNIAK: We've heard that really there haven't been any, or three claims in excess of 500,000 in the last six years.

MR. FISCHER: Well, apparently the loss experience of local entities is not that but taking each municipality or each county looked at individually, it's probably insufficient in size and scope to be able to deal with the problem as an individual unit.

SENATOR LESNIAK: That's why we're going to the pool.

MR. FISCHER: That's right. The concept of the fund is considered positive because it, in effect, allows all of the local and county entities to create an insurance pool for themselves and to share the risk of loss and to be able to take advantage of risk management concepts.

SENATOR LESNIAK: But your statement regarding the large jury awards does not apply either to the history of the State of New Jersey or the public entities of the State of New Jersey.

MR. FISCHER: The State of New Jersey and the large public entities in the State have not--

SENATOR LESNIAK: Other than--

MR. FISCHER: Other than probably one or two cases.

SENATOR LESNIAK: One or two cases.

MR. FISCHER: But have not experienced a sufficient -- a significant poor response from the jury. At the same time--

SENATOR LESNIAK: And yet we hear continually from the insurance industry that New Jersey is the worst case scenario.

MR. FISCHER: Well, I suspect, and I surely don't suppose to speak for the insurance industry, but--

SENATOR LESNIAK: That if you're in another state you'll hear the same thing about that other state?

MR. FISCHER: I suspect that their view is that the risk is there -- the potential risk. As I understand the insurance industry's argument, a case like Jackson Township, or even cases where you have substantial verdicts under a million dollars but in excess of 200,000 or 300,000, somewhere in the range between 200,000 and a million dollars, if you see just some of those, the insurance industry then projects that potential loss, even though it doesn't materialize, to all their future claims. And what happens is you now have to deal with the growth in litigation as these verdicts become known to the public. You also have the insurance industry, in order to avoid what they see as a potential risk, entering into settlements in cases for fairly substantial dollars because cases are not taken to verdict. I mean one of the reasons you don't see substantial verdicts is because most cases don't go to verdict.

SENATOR LESNIAK: And you get one Jackson Township case that's going to provide -- that's going to result in probably 100 additional lawsuits filed that maybe wouldn't have been filed because of the expense of proving that type of case.

MR. FISCHER: That's right, and one loss such as that will terrify the insurance industry because theirs is a purely economic view whereas government obviously is going to look at the potential risks and what they've got to do in response to problems, with their tort liabilities only one element of the analysis.

That's why we think the fund will offer a significant improvement to the insurance situation for local entities. But we say that with two provisos. 1) That the fund be managed and be structured in such a way that it truly uses legitimate risk

management functions. The fund or the commission has to have some authority to reach down and recognize where the losses are, where losses can be improved, what actions can be taken to minimize losses.

SENATOR LESNIAK: Is that authority in the legislation, Mr. Fischer?

MR. FISCHER: I don't recall if it's in the draft. I know I worked on the draft with the administration in which that's been put in. The fund must be actuarially sound. That not only means that the premiums charged, and the distributions given back to the members have to be computed in an actuarially proved manner, but the fund ought to have some life in which all of the local entities must participate in order to maintain the losses, to create a loss experience and to create a continuity.

But even the fund legislation alone would be insufficient because while it will provide some sort of coverage to municipalities, it does not necessarily imply a significant downward trend in the cost of insurance. It really, if it does anything, it makes insurance available. If there's going to be any sort of downward trend--

SENATOR LESNIAK: That conflicts with the Commissioner's testimony. That conflicts with the Commissioner's testimony, you know that, don't you?

MR. FISCHER: I don't think it does.

SENATOR LESNIAK: She's going to be Attorney General next. (Laughter) The Commissioner predicts millions of dollars of savings alone by this.

MR. FISCHER: The savings, the initial savings by the creation of the fund without consideration for the moment of Tort Claims Act reformation.

SENATOR LESNIAK: Okay, well, let's get down to the point. What Tort Claims Act reformation are you talking about?

MR. FISCHER: The most fundamental changes are the creation of a cap on liability, and the creation of a limitation in the concept of joint and several liability as found in the

Tort Claims Act.

SENATOR LESNIAK: Okay. In terms of cap on liability, you believe that an arbitrary cap that can't be relieved under situations where someone is really seriously injured is cruel and inhuman, wouldn't you agree with that statement? That if there were just an arbitrary cut-off figure where we would be solving our problem on the backs of the permanently disabled and the widows and the children. You wouldn't want that, would you?

MR. FISCHER: No, I wouldn't, but I--

SENATOR LESNIAK: So you would agree with a cap with some provision of a waiver or a release of that cap based on certain procedure?

MR. FISCHER: I'm not sure that that's necessary, and I'll go back to the Commissioner's testimony. I've participated every year that I've been section chief in the legislative appropriation process for legislative claim. A fairly straight, a cap in terms of the legislation which does not lead to the courts, the judgment in some sort of amorphic standard as to whether the cap should be lifted or not.

SENATOR LESNIAK: Not to the courts, but to some other--

MR. FISCHER: The Legislature always has the opportunity of--

SENATOR LESNIAK: Sure, we can give away moneys as much as we want, but what I'm saying -- and do in some instances, but what I'm saying is ought not that be put into the legislation?

MR. FISCHER: I think it would be redundant to what already exists and would probably have a negative effect in terms of encouraging insurance companies to come back into the marketplace inasmuch as once again there would be a suggestion that their exposure isn't defined. The creation of a strict cap lets the carrier, lets--

SENATOR LESNIAK: Even though it's-- You're really not making a hell of a lot of sense. Even though it's there already, you're saying it would be redundant? The fact that we put it there even though it's there already would have a negative impact

on the insurance industry in coming into the market?

MR. FISCHER: No. A cap in the legislation would cap the liability of the insurance industry. The opportunity to come before the Legislature to seek a supplementary appropriation for a particular claim is a claim not paid for by insurance.

SENATOR LESNIAK: Okay. So you're addressing an issue beyond what we're talking about today in terms of the public entity liability. Is that what you're saying?

MR. FISCHER: No. I'm saying that in order for public entity liability to be addressed there has to be a cap on the liability of public entities in terms of dollars. Whether that's limited, whether that's strict, whether there is exceptions for economic losses or not would be another issue.

SENATOR LESNIAK: What else? What other issue do you want?

MR. FISCHER: And we would also recommend that there be limitations on the concept of joint and several liabilities as it's applied to public entities under the Tort Claims Act.

SENATOR LESNIAK: Do you want to ask DEP about that and see how they feel? Has the Attorney General talked to the Commissioner of Environmental Protection, to see how he feels about that? Because that's what our Commission recommended, quite frankly, in terms of environmental claims. But the DEP is very much against it. They feel that it would destroy their efforts to clean up the environment and to reduce waste flows and all that kind of stuff.

MR. FISCHER: I'm not sure how that would happen, but--

SENATOR LESNIAK: We're going to have to discuss that at some other time. I just wanted to point out that DEP is very strongly against that.

MR. FISCHER: Thank you.

SENATOR LESNIAK: I lost my list. Susan Connell, Assistant State Treasurer. Susan?

S U S A N C O N N E L L: I don't think I'll come all the way up because I'm just going to give the Treasurer's position.

SENATOR LESNIAK: We have plenty of money to pay for all these claims, is that what you're going to tell us?

MS. CONNELL: Yes.

SENATOR LESNIAK: Nothing to worry about.

MS. CONNELL: She is in favor of the concept of the excess liability pool as a viable solution to municipalities--

SENATOR LESNIAK: Susan, you do have to come to the mike so we can--

MR. DAVIS: Would you come up to the microphone?

MS. CONNELL: I only have about two things to say.

SENATOR LESNIAK: Well, we have to get you on.

MS. CONNELL: Susan Connell, Assistant State Treasurer. While we do see the concept of the excess liability pool as a viable solution to the municipalities, the Treasury opposes the inclusion of the State in the pool because we feel that there is clearly no economic advantage to the State. Bob Hunt, who is the director of our Bureau of Risk Management in Treasury will outline these reasons.

SENATOR LESNIAK: Okay. Thank you very much. Why don't we have Bob Hunt come up. Division of General Services Administration, Treasury. What happened to the spill fund?

R O B E R T H U N T: That was my part-time job.

SENATOR LESNIAK: That's the problem.

MR. HUNT: Mandatory participation in excess insurance liability pool with municipalities does not appear to be financially advantageous to the State of New Jersey. Our size and risk exposures are proportionately incompatible with municipal government. Participation in the proposed pool would most likely result in the State becoming the financial guarantor of the pool while providing very little benefit to the State in the form of payment of liability claims. If the Legislature approves the legislation which is to be introduced to amend the tort law, and will include liability caps, I cannot see any benefit to the State from participation in the proposed excess liability pool.

An actuary study completed in May of 1985 reviewing our general liability exposures indicates that the State has a reasonable frequency of losses. Seven to ten claims per year, which have an injury exposure up to two and a half million dollars per occurrence. Further, our past loss payment history for both automobile and general liability claims confirms that we can expect one to two claims per year where our actual payout will be between 500,000 and $1.5 million per claim.

The philosophy of an excess liability pool is that it should be used for protection against unpredictable losses at a catastrophe level that cannot be reasonably absorbed individually by the pool participants. It would be unfair for the State to be part of a municipal pool where the payment level begins at $500,002 per occurrence when we are predicting that we will have losses above this level. We should not expect municipalities to share in the payment of our losses under these circumstances. Under our present arrangement we are self-insured up to two and a half million dollars per occurrence for general liability claims and we must go to the Legislature for an appropriation when actual payments are due.

Mandatory participation in the proposed pool would required that we revise this process and go to the Legislature each year and ask for liability appropriations to be deposited in the pool. At two and a half million dollars per occurrence the State will buy insurance if the cost is reasonable. While we have never experienced a claim above this level, unlike municipalities, the catastrophe level for the State probably begins at $10 million per occurrence. Since a serious claim is usually not paid until at least five years after the occurrence we would be able to predict the anticipated loss value and budget a $10 million claim at $2 million per year, which would be a rather reasonable number for the State to handle.

If the State is mandated to participate in the pool we would clearly be the largest public entity participant. By any traditional underwriting basis, such as number of employees,

budget, vehicles, population, square miles, miles of roadway, or even loss experience, we will become the major contributor to the pool. Therefore it can be reasonably expected that adverse loss experience by the pool will have to be absorbed by increased assessments based upon ability to pay, or somewhat equal to the original contributions. If this occurs it is easy to see how the State will wind up subsidizing municipal liabilities and thereby guaranteeing the financial stability of the pool.

The weight of the financial impact to the State upon proposed pool can be seen even better when we consider other major autonomous state agencies which also have proportionately larger risk exposures than local public entities. Examples of these would be New Jersey Transit, the Sports Authority, the Turnpike Authority, the Highway Authority, Rutgers University of Medicine and Dentistry, and New Jersey Water Authority.

SENATOR LESNIAK: Okay. You're out. Thanks. Linda Spalinsko, Assistant Executive Director of the New Jersey Association of Counties.

I can't help but notice but Ted Reid is here from the Boards of Education Association. I presume that you will be developing some position at some point in time and will submit it. Thank you, Mr. Reid.

L I N D A S P A L I N S K I: Good afternoon, Mr. Chairman. My name is Linda Spalinski and I'm the Assistant Executive Director of the New Jersey Association of Counties. I want to thank you for the opportunity to comment on this very important legislation.

Let me begin by noting that neither our legislative committee nor our board of directors has had the opportunity yet to review the details of Senate Bill 1718. Therefore my remarks should not be construed as an official position of the New Jersey Association of Counties. I do hope, however, that I can shed some light on the county perspective on this critical issue.

At the request of the New Jersey Department of Insurance the New Jersey Association of Counties is currently conducting a

survey of the 21 counties. Not surprisingly, the responses we have received thus far show that premiums for liability coverage are skyrocketing with increases of 200, 300 and 400% being commonplace. Coverage limits are being reduced and new exclusions are being added to the policies, particularly in the area of pollution. In some cases excess liability coverage has not been available and the affected counties have moved towards self-insurance programs.

In short, counties in this State, as well as across the nation, are experiencing a crisis in the availability and affordability of liability insurance. I would suspect that the situation facing municipal governments is even more severe and we certainly share the concern of municipal officials in finding acceptable solutions to the problem.

The idea of creating an excess liability insurance commission as proposed in your legislation has sparked considerable interest among the counties. I would hesitate, however, to predict an unanimity of position among the 21 counties. Some counties, particularly those with good loss histories, may object to mandatory inclusion in the fund. Counties that express support to for the concept suggest that contributions to the fund should be experience rated. Undoubtedly counties will be greatly concerned about the procedures for the assessment of member units. In this regard let me suggest that this Committee give consideration to including in the legislation a provision for a public comment period prior to the commissioner's approval of the funds bylaws and risk management plan.

Another aspect of the legislation which is likely to be of some concern to the counties is the responsibility for defense costs. The bill in its present form does not relieve governmental units of the cost of defense for claims exceeding the $500,000 threshold. Legal fees for these claims can be exceedingly costly and I believe that the counties would expect that the commission should bear some responsibility in that area.

SENATOR LESNIAK: Doesn't the primary insured bear the legal expenses generally? I mean the--

MS. SPALINSKI: Some counties have expressed some concern that the State develop a system of alleviating some of their costs in this area.

SENATOR LESNIAK: But I mean basically you would have coverage, some form, either self-insurance or insurance--

MS. SPALINSKI: Right.

SENATOR LESNIAK: -- and that would provide for the defense cost--

MS. SPALINSKI: As I've been told--

SENATOR LESNIAK: --unless they throw in the policy, I guess.

MS. SPALINSKI: As I've been told by at least some of the counties -- and again, we haven't heard from all of them -- that they are bearing at least some portion of the defense costs and this is an area of concern for them.

Going beyond the concept of an excess liability fund, I should point out to your Committee that there appears to be fairly widespread support among the counties for a broader approach to tort reform. Various suggestions have been advanced, including limiting the liabilities of public entities for catastrophic losses, placing limits on pain and suffering awards, addressing the issue of joint and several liability as proposed in legislation sponsored by Senator Gormley and Assemblyman Zimmer, capping legal fees at a reasonable level. Additionally there is some thought that an excess liability insurance fund may have wider acceptance if it were restricted to environmental claims.

I hope that during the course of your deliberations you will give serious consideration to all of these proposals. A complex issue such as this is bound to produce many different points of view. Senate Bill 1718 will be a prime topic of discussion at the next meeting of the New Jersey Association of Counties, which will be held early in April. Our goal will be to

develop a consensus position which will adequately represent the interest of all counties. I hope that we will have further opportunity to comment on this very critical area of interest. Thank you very much.

SENATOR LESNIAK: Certainly you will have additional opportunity to present comment after the Association meets, if it meets in April, because we'll still be working on the bill by then, but we expect to do something shortly thereafter.

Let me just ask you one question. The problem of affordability and availability of insurance for counties is not limited to environmental claims?

MS. SPALINSKI: Oh, no. No, it runs across-the-board; auto, general, public official.

SENATOR LESNIAK: Okay. Peter Strauss, Alliance of American Insurers. Finally you're getting an opportunity to be heard. We've heard from everyone else.

P E T E R S T R A U S S: I'm not sure, but somehow I get the feeling that people are going to be listening to me very carefully. I don't have prepared testimony. However I would like to give you some figures and I'll be getting to them in my statement.

I am Peter Strauss. Government Affairs Representative for the Alliance of American Insurers. The Alliance represents approximately 175 companies nationally. We are a national property casualty trade association. Many of our members are very active in the New Jersey markets.

Specifically on Senate Bill 1718 we can't oppose the idea of a self-insurance pooling mechanism for almost anybody.

SENATOR LESNIAK: Let me just say this. It's not necessarily self-insurance pooling, is it? Are we limited, does this pool have to be a self-insurance pool, I mean?

MR. STRAUSS: Well, where does the money come from?

SENATOR LESNIAK: They can get insurance.

MR. STRAUSS: The money comes directly from anybody who -- well, over $500,000 any money to pay claims comes directly

from those--

SENATOR LESNIAK: What I'm saying is I don't think anything restricts them from buying, taking that money and buying insurance.

MR. STRAUSS: Up to $500,000 they can.

SENATOR LESNIAK: No, no.

MR. STRAUSS: Over $500,000?

SENATOR LESNIAK: Yes. In other words, they'll collect the "premiums," the assessments and we'll make a determination as to whether to self-insure or use that money to buy insurance. So it's not necessarily a self-insurance excess liability fund. It's an excess liability fund. So, you know, you guys can put your bid in.

MR. STRAUSS: I stand corrected.

SENATOR LESNIAK: And should, and should put it in.

MR. STRAUSS: Well, if it operates as a self-insurance, should the pool decide to operate in such a manner we would ask that within the bill somewhere you mandate that the pool as operating as a self-insured be regulated by the Department and that it meets the requirements that an insurance company has to meet to operate in the State, because, in effect, that's what they're doing.

SENATOR LESNIAK: You want them to pay taxes?

MR. STRAUSS: They're operating as an insurance company. If they don't have the loss reserves to pay the claims, then the entire association and the members in that association are down the tubes.

SENATOR LESNIAK: Well, isn't it --

MR. STRAUSS: In other words, the money is going to come directly from their pockets.

SENATOR LESNIAK: Isn't it a little different from an insurance company because they can go back and collect the losses through assessments. Insurance companies can't do that. They can just increase the premium and your policyholder can say good-bye, get lost, or may not even be around. So it is a little

different from insurance company.

MR. STRAUSS: It is a little different.

SENATOR LESNIAK: In that regard.

MR. STRAUSS: However, those assessments can be fairly large.

SENATOR LESNIAK: Sure.

MR. STRAUSS: Insurance companies have the ability to spread the risk a little bit more, and this is insurance theory, not always practice. But it works because they can spread the risk a little bit more. In this situation they can't. They can only go to one place and essentially it winds up being the taxpayers' pockets.

SENATOR LESNIAK: Sure, the 567 municipalities, how many school boards? How many school boards in New Jersey?

UNIDENTIFIED SPEAKER FROM AUDIENCE: 612.

SENATOR LESNIAK: 612 school boards.

MR. STRAUSS: Then "X" number of authorities, etc., etc.

SENATOR LESNIAK: Have you determined that figure -- all those figures yet? Do we have that nailed down? You're giving me a blank stare.

MR. DAVIS: No. I gave you some figures for something but--

SENATOR LESNIAK: In any event--

MR. STRAUSS: It comes out of our pockets as residents of the State.

SENATOR LESNIAK: Do you want to explain these figures to me? I can't read these.

MR. STRAUSS: Let me explain a little bit more about our feelings on the bill.

SENATOR LESNIAK: Okay.

MR. STRAUSS: I think that the problem for the most part with municipal liability insurance is the environmental coverage -- pollution coverage. I know you're familiar with the Jackson Township case and really that has got underwriters quite scared. You may say that underwriters are a nervous type anyway.

I guess that's part of their profession. But when the court in New Jersey says that what you wrote in a contract is not really what you meant, underwriters go crazy.

SENATOR LESNIAK: You know very well that I've been waiting for language from the insurance industry. Maybe it was ultimately determined even if we adopt it as a legislative policy it's not going to be helpful. I happen to think that it will. We have a difference of opinion there. If that, in fact, is the case, though I certainly have been willing and able to draft legislation establishing as a public policy that, however we would word it, which I think would send a strong message to the courts. You know, the Mount Laurel III didn't come out of a vacuum. I think Justice Wilentz heard the knockings on the door and shifted all those cases over to the Fair Housing Council. So I think he does read the paper and he does read what's coming out of the Legislature. So I'm just giving you another pitch that I would like to go ahead with that. I'll see Dennis Connell up in Albany. We're on the same program together next week, and remind him.

MR. STRAUSS: It's a tough nut because what you and I would describe as sudden and accident--

SENATOR LESNIAK: This is a private conversation.

MR. STRAUSS: Shall I explain?

SENATOR LESNIAK: Sure.

MR. STRAUSS: The problem in Jackson Township was specifically the justices decided that sudden and accidental pollution coverage, which was available to the municipalities and sold to the municipalities under the comprehensive general liability policy that they bought, actually meant all the pollution that affects people suddenly and accidently, not as it occurs. Sudden and accidental to the insurer's mind was burst of a tank, the breaking of a valve, where there is a sudden and specific incident that there is pollution leak.

SENATOR LESNIAK: Those examples can actually be cited in either policy statement or an actual bill that would really

give the court that action. Of course, nothing would prevent former Supreme Court Justice William O. Douglas from saying Congress could not have meant what they said. They can't do that.

MR. STRAUSS: Are you selling your used car?

SENATOR LESNIAK: No, I just think that it would have an effect, but -- and I'm waiting. Okay.

MR. STRAUSS: In any case, we have the situation now where the pollution exclusion form has been approved by the Commissioner. I've just heard it today. However, we're in a Catch-22 because the current emergency regulations on non-renewal and cancellation do not permit us to use that form. So there's a circular kind of problem.

SENATOR LESNIAK: Is that being held over your head until you get into the MAP program?

MR. STRAUSS: Let me say this about the MAP program. The Commissioner has got commitments -- personal commitments -- from 12 out of the 15 largest commercial liability writers that it will work. After all the negotiations that we did to get the changes in the regulation and to commit to a MAP that we felt we could live with, if we don't make it work I may be selling used cars.

SENATOR LESNIAK: So that's going to happen.

MR. STRAUSS: I expect that the MAP will be effective. The MAP has been effective in New York. It's going to be effective in Pennsylvania. It's been effective in other parts of the country. It will be effective with New Jersey with any luck.

SENATOR LESNIAK: And the emergency regulation will be off and will be supplemented by the new proposed regulation?

MR STRAUSS: And we will be able to--

SENATOR LESNIAK: And that you can have your pollution exclusion.

MR. STRAUSS: And I think that will make a difference in the market.

SENATOR LESNIAK: And therefore you'll see all of a

sudden you guys will start cutting your prices and municipalities' and public entities' costs will come down, will be available, and we won't need this bill. I was giving your testimony.

MR. STRAUSS: Funny you should mention that. Now I'll explain the figures. You really want to get to these, don't you?

I've handed you figures. The first page is general liability insurance for municipal classes. These are figures from the Insurance Services Office on the latest figures that they have, from 1980 to 1983. You see a comparison of total limits, earned premiums, developed basic limits, incurred losses, developed excess limits, incurred losses, number of claims, and then total limits loss ratio. This is a ratio of what we took in in premiums to what we paid out -- claims.

SENATOR LESNIAK: Is there something missing here?

MR. STRAUSS: You've got a comparison of New Jersey and countrywide. What--

SENATOR LESNIAK: Is some figure missing here?

MR. STRAUSS: I don't follow.

SENATOR LESNIAK: What do you do with the premiums?

MR. STRAUSS: Investment income?

SENATOR LESNIAK: That's it. I knew something was missing. Funny I should -- that's the next thing.

MR. STRAUSS: Wait, there are more pages. I am prepared. believe it or not.

SENATOR LESNIAK: I'm sure.

MR. STRAUSS: Just don't jump my figures yet. But let me point out to you that the loss ratio for these municipal classes ranges from 4.4, that is for every dollar in premium we took in that year we paid out $4.40.

SENATOR LESNIAK: Am I reading this wrong? Is it going down over the last two years?

MR. STRAUSS: More or less, but it's still, the last figures for 1983, the last figure is $3.50 plus or minus for

every dollar in premium. You're still running a losing operation. And if you look you've got a terrible increase in claims of almost double there. You also have an increase--

SENATOR LESNIAK: But a loss-- Okay, I'm sorry.

MR. STRAUSS: --of almost 50% in the premium taken in, so that explains part of that. The next page is for governmental--

SENATOR LESNIAK: I'm sorry.

MR. STRAUSS: Okay.

SENATOR LESNIAK: When will the '84 figures be available? Eighty-four, we're at '86 already.

MR. STRAUSS: Eighty-four-- Nothing happens overnight in this industry.

SENATOR LESNIAK: I know that. I thought government was slow.

MR. STRAUSS: We have to wait for claims to mature. Incidents have happened already and claims will arise sometime in the future. In fact, these 1980 figures -- the books won't close on them for 30, 40 years.

SENATOR LESNIAK: You have to adjust them. You have to adjust them, but you should have some base line figures for '84, shouldn't we?

MR. STRAUSS: I believe we should have those figures by the end of the month.

SENATOR LESNIAK: You'll get them all to me?

MR. STRAUSS: Of course.

SENATOR LESNIAK: By the end of next year. Okay, appreciate it.

MR. STRAUSS: As soon as they are available. It's a standard insurance industry line. However, compare the New Jersey experience to the countrywide experience and you see that New Jersey is far, far worse by almost double countrywide.

SENATOR LESNIAK: Well, let me tell you one thing that comes to mind. When did we deregulate commercial insurance? When did we -- no, no. When did we deregulate?

MR. STRAUSS: Commercial lines, 1982.

SENATOR LESNIAK: 1982.

MR. STRAUSS: And you see that premiums did go up and the loss ratio did go down.

SENATOR LESNIAK: Okay.

MR. STRAUSS: So we move on to governmental subdivision, which is separating out different kinds of classes, more specific types of classes, and the total limits loss ratio looks even worse. In 1982, $16.72 paid out for every dollar in premium taken in. That figure dropped tremendously in -- I'm sorry, that was a 1981 figure. 1982 was $6.20 but 1983 we're back up to $9.62. Again, if you compare that to the national average New Jersey is nine times worse, six times worse, and 16 times worse than the national average by a year.

SENATOR LESNIAK: Can I-- I like these figures.

MR. STRAUSS: These are fun, aren't they?

SENATOR LESNIAK: Can we stay up all night and look at them? Do you have similar figures for industrial type states: New York, Ohio, Pennsylvania?

MR. STRAUSS: I have figures for Pennsylvania with me. I'm sure I can--

SENATOR LESNIAK: You thought I was going to ask that question.

MR. STRAUSS: Well, I cover New Jersey and Pennsylvania. I've got to carry this stuff. But I can get you the figures for the other states.

SENATOR LESNIAK: I would be interested.

MR. STRAUSS: Sure.

SENATOR LESNIAK: Some kind of representative sampling of similar types of states.

MR. STRAUSS: No problem; Ohio, Illinois.

SENATOR LESNIAK: Michigan.

MR. STRAUSS: Michigan, California, Florida, New York, the usual round of suspects.

SENATOR LESNIAK: Yes.

MR. STRAUSS: Okay. Let's move on to streets and roads, which is the next page. Traditionally these are where most of the claims come in because people injure themselves on potholes, cracks in the sidewalk and again--

SENATOR LESNIAK: Who has more streets and roads than New Jersey per population? And, of course, we're going to have $2 billion more if Bo Sullivan has his way.

MR. STRAUSS: I just do insurance lobbying. I don't know from roads.

SENATOR LESNIAK: You can't be a straight man. Okay.

MR. STRAUSS: And again, you can see that the differences between New Jersey and countrywide are generally about double.

SENATOR LESNIAK: Does this mean that we have better attorneys than the rest of the country?

MR. STRAUSS: That's very possible. The last page I have on these figures are for public schools. And here we're looking at a range to $1.30, $2.00, $2.80, $3.00, and finally a total of $2.66. As opposed to nationally we're about a dollar higher than countrywide. Do you have the public schools page?

SENATOR LESNIAK: Yes.

MR. STRAUSS: Okay. Now we get to some charts.

SENATOR LESNIAK: I like charts, too.

MR. STRAUSS: This is out of an Insurance Services Office book that was just published and I have one copy, and I'm not going to give it to you.

SENATOR LESNIAK: Why did you stick the GNP in there? How does the GNP get in there? I mean why didn't you put the Mets' won and loss record over those two years. I mean it's about as relevant.

MR. STRAUSS: Because the Mets won/loss record compares well with the stock market. The purpose for this chart was to show you a comparison of what losses, premium and how the economy in general has been going. This first one is for commercial lines, all commercial lines. That would include municipalities,

commercial, auto, and you can see that for the most part until 1983 written premiums have been flat or losses have increased fairly dramatically. The GNP has increased nicely.

SENATOR LESNIAK: And with GNP increasing is increasing in earnings which mean increasing loss of earnings as a result of--

MR. STRAUSS: Increasing investment income, is that?

SENATOR LESNIAK: No, not necessarily. Increasing loss of earnings. Go ahead.

MR. STRAUSS: I just think it is an irrelevant line for purposes and I'll drop it if you will.

SENATOR LESNIAK: Probably.

MR. STRAUSS: Okay. The next chart is commercial liability and this would include municipals with municipal liability. And this is strictly on liability insurance and you can see that while losses actually went, or premiums went down from 1979 to 1983 the paid losses, and this is actually paid losses. This isn't done yet. There are still plenty of claims that are going to come in for this money. It's tremendous, and I'm going to take--

SENATOR LESNIAK: Who forced you to cut your premiums, that's what I want to know?

MR. STRAUSS: Part of that is competition, tremendous competition. And you'll get to the next chart and that will be really interesting for you. But let me take this opportunity to show the audience what we're talking about here. (Laughter) This is paid losses. These are the premiums.

Now the next question is how come those premiums are like that? The reason is competition and investment income. I'm not afraid to say it. We've made -- we did pretty good on our investments. We did very good. And the next chart shows you exactly what's going on with our investment income. It is continually rising and from '79 to '81, '82 we had some very good increases. However, at the same time the losses were increasing tremendously and in the last two to three years from '82 to '84

-- here, let me do that.

SENATOR LESNIAK: I'll ask the questions here. What one's on top of this column over here?

MR. STRAUSS: On top of the investment income column?

SENATOR LESNIAK: Yes. What other thing could be placed right over there? How about premiums?

MR. STRAUSS: Premiums could be.

SENATOR LESNIAK: It would be nice if we had something showing that. That would give a nice picture, if you had a different color.

MR. STRAUSS: That's true. I don't know if I've got that in the book. I will look for it. But the point here is that these invest-- This investment income really did keep premiums down and while investment income did not decrease in recent years, losses grew tremendously to the point where on underwriting results, on the business of insurance our losses have exceeded investment income.

SENATOR LESNIAK: You know what?

MR. STRAUSS: And this darker line is the business of insurance, not the business of investment. This is losses in comparison to what we take in premium.

SENATOR LESNIAK: The whole thing, the whole picture is the business of insurance. There is one thing, one point, however, that's -- I don't know what the impact, what it means, however, is that I'm sure during this period you've had an increase in premiums, right? At least between '83 and '84 you did.

MR. STRAUSS: Eighty-three, yeah. These figures are 1984 because that's the latest figures we've got. We'll have 1985 at the end of this month.

SENATOR LESNIAK: It would be interesting to know the percentage increase in investment income compared to the percentage increase or decrease in premium. I don't know for what purpose, but that could be interesting to know.

MR. STRAUSS: There have been comments that we've been

overstating reserves to making it appear that we're profitable. And this last chart shows you what happened to reserves that were set up in 1976 for all lines and this is for 1986 claims. We've already paid out in 1984 more money than has been set aside and claims are still coming in for 1976. So that's the end of my show and tell.

However, the pollution problem that we face really is a problem that insurers have because pollution has become almost uninsurable. There is only a certainty of loss. There is no prediction as to when, to what extent that loss will come in, how that loss will come in. And our technology is proceeding in finding ways to discover injuries. Our technology is not proceeding in ways to prevent these new injuries. We're human. We're going to make mistakes. Landfills, dumps, whatever you want to call them, are going to leak. That's a certainty because we have never found a way to make anything perfect. In fact the EPA has said that every one of these things is going to leak.

SENATOR LESNIAK: Absolutely.

MR. STRAUSS: So we find it very hard to insure something that is a certainty of loss but not knowing when, how much, on what grounds, and who is going to be brought in.

This is not only a New Jersey problem, this is a national problem. We look at the bill and we look at the situation and we would call for several liability to replace joint and several liability because under joint and several liability even if the municipality were only one percent at fault and the rest of the defendants either had little ability to pay or proved to be judgment proof, the municipality would be stuck for most of the award, if not all of it, should they be judgment proof.

Should, under the bill, this fund -- this pool -- choose to be self-insuring we would request that it be barred from access to the guarantee funds because the guarantee funds--

SENATOR LESNIAK: They don't have access to it. They don't have access to it. We would have to give them access to it

by legislation, and if we barred it now, that would have absolutely no impact because another Legislature could--

MR. STRAUSS: Could.

SENATOR LESNIAK: Unbar it. Just as they would, just as they would have to come to the Legislature to get the authority. So it--

MR. STRAUSS: Well, we would feel more comfortable if a bar were in there because it's harder to change a law than it is to create a law. That's our feeling.

SENATOR LESNIAK: Harder to change a law than it is to create a law.

MR. STRAUSS: Statutory, through the Legislature.

SENATOR LESNIAK: Depends.

MR. STRAUSS: Look at the number of new proposals, look at the number of new proposals in the Legislature as opposed to the number of proposals to change something that is already there. Look at the success ratio of those proposals, etc.

SENATOR LESNIAK: What about a requirement that the fund compare the cost of insuring the excess liability as opposed to self-insuring?

MR. STRAUSS: One more time?

SENATOR LESNIAK: Okay. What about requiring that the fund compare the cost of buying insurance with the premiums from the public entities to cover the excess liability with self-insuring?

MR. STRAUSS: I think when you first start a company as a self-insuring entity would be the difference is going to be fairly dramatic because the self-insured doesn't have the experience, doesn't have the exposure that the insurance companies do, because we have been writing this coverage for a few years already. So we have liability for claims on policies that are 30 years old whereas the self-insuring entity really wouldn't.

SENATOR LESNIAK: I know but I'm not making myself clear. As I said before, this fund can insure their exposure as

opposed to self or keeping. They can get rid of the risk or keep the risk. What about requiring them to compare the cost in making a decision that's most -- least expensive? I just thought out--

MR. STRAUSS: Interesting thought. Part of the problem, we've found, with municipal liability insurance is that coverage really is put out to bid. I'm not sure if that's a State law or local ordinance, or just local practice. And you're required, really you have an obligation to take the lowest bid.

SENATOR LESNIAK: Right. They're not.

MR. STRAUSS: No?

SENATOR LESNIAK: That's a professional services exception to the public bidding laws.

MR. STRAUSS: I think that in practice you'll find that the risk manager for a locality--

SENATOR LESNIAK: Does the prudent thing. Doesn't preclude them from bidding.

MR. STRAUSS: This is true. At least some of my companies don't want to do business on that kind of an arrangement where every year they're forced to submit a bid because they want the security--

SENATOR LESNIAK: Some of them will be aggressive and, in fact, bid because they want the business and that's what makes the world go round.

MR. STRAUSS: That's true. It's an individual business decision. There are advantages to risk management, and we have supported risk management programs. We've activated risk management programs and aided in risk management programs. However, in a pollution situation risk management may make a situation safer but it does not prevent claim from coming in -- does not necessarily reduce the number of claims that will come in. We have liabilities from 30, 40 years ago and risk management enacted today are not going to do anything about those claims.

Essentially another problem that strikes me with this is

that if this pool decides to purchase insurance they're going to be buying an amazing amount of coverage. I don't know if there are insurers large enough to provide that coverage. You have to set aside "X" amount of dollars for every dollar in premium that you take in.

SENATOR LESNIAK: We're only talking about excess liability.

MR. STRAUSS: For all the municipalities.

SENATOR LESNIAK: The entire State.

MR. STRAUSS: In the State, for every municipality in the State.

SENATOR LESNIAK: But the history over the last six years has been in terms of claims over 500,000 has been minimal. You guys will bid on this. Some of your guys will bid. I have confidence in the industry.

MR. STRAUSS: We are always willing to work with--

SENATOR LESNIAK: You're coming back strong.

MR. STRAUSS: Kind of like the Mets.

SENATOR LESNIAK: Okay. Thank you, Peter.

MR. STRAUSS: Thank you.

SENATOR LESNIAK: Richard Shuss. Administrator in Spotswood. Doubleheader. Richard Shuss and--

W I L L I A M K U R T Z: William Kurtz.

SENATOR LESNIAK: William Kurtz, also Spotswood?

MR. KURTZ: Insurance consultant.

SENATOR LESNIAK: Okay.

R I C H A R D S H U S S: Richard Shuss, Administrator in Spotswood. We wanted to show you in microcosm what's happening in the small community in New Jersey. You may have heard from the larger ones and maybe it is a typical example. In our particular case being a very small burough last year we had a million dollars in general liability coverage and $5 million in excess. Our cost was about $21,000. This year we have $490,000 as the maximum we were able to obtain. The cost is $90,000 and we have no excess coverage whatsoever.

In order to get excess coverage we would need to purchase a buffer policy to between the 490 and the million. That buffer cost would be $150,000 to $200,000. The first million in excess insurance would then cost us at least $50,000. In order to obtain one-third of the coverage that we had last year our cost would go up from 21,000 to over a quarter of a million dollars. Maybe this is typical of what's happening in the State. Our numbers may be small but they're very important to us.

On that basis we feel as though we are compelled to join a pool. Fortunately Mr. Kurtz has organized a pool in Middlesex County. We have about a dozen communities that are already involved in the pool. However, part of the condition of that pool is that excess liability insurance be available. We do not believe that we can obtain it in any other way unless it is obtainable through the State.

I brought Mr. Kurtz so that you could ask him questions that you might wish to about the pool which we believe will be the third one in the State of New Jersey. We expect to have that up and running by June 1.

SENATOR LESNIAK: Could you send me something, a brief outline in terms of the way it will be administered and set up? I'd be interested in that.

MR. KURTZ: Yes, sir. There are 10 towns that are fairly committed to this pool. The 10 towns are now assessed and paying close to 2,700,000 in insurance premiums. Losses average paid and incurred over the three or four year period around 1,100,000 allowing for inflation. The concern of many of the towns are if we do not have the excess cap in place over the $500,000 it's going to defeat the purposes of the pool. However many towns, such as Spotswood, the smaller towns in central Middlesex County are faced with a limit of 500,000. I know one that can only purchase 100,000 of liability coverage at this particular time. So while the strength of the pool would be of great benefit to the smaller towns, such as Spotswood,

Middletown, and Metuchen, we're still very much desirous of getting excess liability insurance in place.

SENATOR LESNIAK: Let me ask you this. What's the-- Who is the motivator in this? I mean, are you involved with the Board of Freeholders at all? Is it just through municipal, the mayors and--

MR. KURTZ: Just through municipal mayors. Senator Lynch -- I also do work for the City of New Brunswick. We discussed this last January with him and we sent out mailings to every county in Middlesex County whether or not they would be interested in the formation of such a pool. They returned the underwriting data and the increase in their premiums to us. Then when we coupled that with the loss experience derived from the companies we said yes, a pool is definitely viable for these towns in Middlesex County. As I said, there are 12 interested. Ten are pretty much firmly committed to go if we can get the excess in place.

SENATOR LESNIAK: Thank you very much.

MR. KURTZ: Thank you for your time.

MR. SHUSS: In this process we've been aided and abetted by the Department and especially Mr. Grove. I'd like to thank you for initiating the legislation and for hearing us today.

SENATOR LESNIAK: Thank you for coming here. Betty Wilson, The Center for Non-Profit Corporations, former Assemblywoman from Union County.

B E T T Y W I L S O N: My name is Betty Wilson. I'm President of The Center for Non-Profit Corporations. I want to thank you, Senator Lesniak, for introducing S-1718 and for holding this hearing today. We believe your proposal promises significant relief from the current insurance crisis without removing the rights of victims of negligence.

I'm requesting that you amend your bill to include coverage for tax exempt, nonprofit organizations. We believe that your bill will result in lower premiums and ensure available coverage for these groups.

Nonprofit groups are especially vulnerable to the premium increases because of their limited cash reserves. They often cannot raise their fees because their State contracts prevent it, or more so, because they're too poor to pay any more money. Furthermore, good public policy demands that taxpayer and charitable dollars are best spent on more and better services rather than on unreasonable insurance premiums.

Thousand of New Jersey nonprofit groups -- and there are about 4,000 -- and the people they serve, are suffering from the current liability insurance crisis. The nonprofit community is made up of day care centers, group homes, theatres, mental health centers, alcohol and drug treatment facilities, dance groups, senior citizen groups, and a host of others. Many care for our neediest and most vulnerable citizens. These community groups have been struggling with this insurance crisis for many, many months. Insurance has become nearly impossible to buy because insurance companies, forced to renew policies by the New Jersey Insurance Department regulations, have raised prices to staggering, unaffordable levels.

One Head Start group that I know of up in Passaic County has its premium raised by over 2,000%. It's premium went from $631 to $13,200. A battered women's shelter in Camden was able to renew its professional liability insurance for counselors only at a whopping 500% increase for reduced coverage.

One community based organization that I know of, I've a stack of over 100 case examples -- a community based organization in the city -- in an urban area in New Jersey offers day care center, senior day care, and also care for children, tenant counseling, shelter for adolescents, has its premium -- has its renewal premium raised so much last September that they were absolutely unable to afford the renewal. So they went looking around and they found a surplus lines carrier that would write a policy for them, but they had less coverage. But they were forced to take that, make that choice. At Christmas time they gathered toys for the children in their neighborhood to give them

for Christmas and the place was broken into. The toys and their computers were stolen. They suffered a $10,000 loss which they could not collect on because it was not covered by their new insurance policy. That is a direct effect on the poorest people in our State and it's the kind of suffering that I think you would agree, is intolerable. I have dozens more examples that I could give you.

Bad claims experience has no part in this. In fact, a survey of New Jersey day care centers, for example -- and that's the area of the nonprofits that is usually talked about most and that is targeted the most -- the survey shows that they are such good risks that insurers ought to be clammering for their business. Very much along the lines of what you were talking about with municipalities. They just are not paying off claims. A report from Nick Scalera, who is an assistant director of the New Jersey Division of Youth and Family Services says that 81.3% of day care centers surveyed reported no claims over a five year period from 1980 to '85. Of the claims that were settled, 67% involved awards of under $200 each.

Refuting claims about child sexual abuse at day care settings, Scalera said of 44,000 reported cases of abuse and neglect in 1984 only 200 involved child care centers. Of the 200, 18 were substantiated. That's less than one-half of one percent. This is truly a fabricated crisis. In no case that I know of is there evidence of big claims paid out that would justify these staggering premium increases.

Some legislative relief has been offered. Senator Ewing's bill, S-346, passed last Monday in the Senate. That bill exempts persons volunteering to serve without compensation on the boards of various religious, charitable, and educational organizations from liability. Assemblyman Otlowski introduced a bill, A-1821, that would permit nonprofit corporations to form joint self-insurance pools and we enthusiastically support both of these bills. They are a partial solution.

However, we too need the kind of relief your bill

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promises to units of government. A guarantee of liability coverage over $500,000 and rates that are related to the claims that are paid on our behalf. The issue is fairness. The State and its citizens rely on nonprofits to deliver vital community services. Over nine percent of New Jersey's workers are employed in nonprofits. That's double the number in petroleum and chemical industries. Most of our thousands of nonprofit groups will not be able to afford the staggering premiums and loss of coverage unless relief comes soon.

I know that in my discussions with you in advance of these hearings, that you have some concern about drawing into this safety net private organizations. But I would ask you to reconsider nonprofits because they are -- there's a special relationship between nonprofit organizations and the government here in New Jersey. The nonprofit sector is doing much of government's work for it, either through contracts -- mostly through contracts for service. The nonprofit sector is tax exempt. That's what we're talking about here is the tax exempt, nonprofits. It has already been acknowledged by the Federal government, the Internal Revenue Service, and by State government and local governments that they are a subsidized part of the economy and they enjoy a preferred status.

I would invite you to consider our request and offer my assistance in any way that I can help to redraft or amend the legislation to include the nonprofit sector.

SENATOR LESNIAK: Let me ask you one question. One of the reasons why this concept works is that it doesn't have to set aside large reserves for claims because it can go to its membership for assessments to pay any claims. We know the membership is going to be there and has to pay it. We don't always know that in the case of a nonprofit organization, do we?

MS. WILSON: Well, I think the government has already demonstrated its belief in the nonprofit sector because of the services that the government depends on the nonprofits to deliver. The major share of the budget of the Department of

Human Services, for example, is for purchase of service. So I think that, in fact, the government has already expressed its confidence in the nonprofit sector.

SENATOR LESNIAK: But I know the City of Elizabeth is going to be there next year. I'm not so sure that the day care center in Spotswood, just because they are up there, will still be there. That's--

MS. WILSON: Well, you might want to-- We might discuss some standards of judging, for example. Perhaps a nonprofit would have to be in existence for a while, have demonstrated its fiscal soundness and maybe some standards along those lines could be considered.

SENATOR LESNIAK: Have you discussed this with the Department?

MS. WILSON: With the Department of Human Services?

SENATOR LESNIAK: Of Insurance.

MS. WILSON: Excuse me, of Insurance. No, sir.

SENATOR LESNIAK: Well, either, either.

MS. WILSON: No, I haven't.

SENATOR LESNIAK: I would suggest that maybe the Department of Human Services may be interested. No? Yes?

MS. WILSON: Interested in forming or in assisting us with drafting amendments or in supporting the idea?

SENATOR LESNIAK: I mean I would think that they should have an opinion one way or the other.

MS. WILSON: I think that -- Commissioner Perselay is not here and I cannot, of course, speak for him, but Commissioner Perselay has been a very ardent spokesman for relief for the nonprofit sector. He testified at Assemblyman Otlowski's hearings and also before Commissioner Gluck. I would be happy to work with them to--

SENATOR LESNIAK: Okay, and he asked -- he did call me yesterday. Maybe that is what it was about. I didn't get a chance to call him. I will call him.

MS. WILSON: Okay. Thank you very much.

SENATOR LESNIAK: Thank you. Joseph Vozza, Administrator and Executive Director of Bergen County Joint Municipal Insurance Fund. This is really nice. Can I indulge you just for one minute? I know you've been patient. Can I ask that you summarize your testimony instead of reading it into the record.

J O S E P H V O Z Z A: Okay. Let me just--

SENATOR LESNIAK: I prefer to work that way when I get tired.

MR. VOZZA: Okay. My name is Joe Vozza. I'm here as the Executive Director of the two Bergen municipal self-insurnce pools and with me is Janet Lynn, who is tne chairperson of the South Bergen group.

SENATOR LESNIAK: There is a North Bergen pool and a South Bergen pool, is that what it is?

MR. VOZZA: Yes, that is correct.

SENATOR LESNIAK: Did you try and get topetner? I mean how did that come about?

MR. VOZZA: Well, we started off with tne North Bergen group first on January 1, 1985 and it was growing. There are 29 municipalities in that group and then we had -- they wanted to keep it on a certain local area basis because they feel that it is easier to handle safety programs and get tne participation of the communities that they feel is essential to the success of these pools. So when some of the committees in South Bergen sent up inquiries as to whether or not they could join the North Bergen group it was decided to set up a separate group down there. Collectively--

SENATOR LESNIAK: Actually, all you have to do is read one paragraph of your testimony: "Our insurance budget for both Bergen funds exceeds 2.2 million dollars. Approximately 1.5 million is for excess liability insurance. Is estimated that we could expect a savings of about $800,000 if tne Inter-Governmental Excess Liability Commission is created."

MR. VOZZA: Okay, but there's a couple of otner tnings I

think the Committee ought to be aware of, and that is that success of these pools depends upon proper structuring of the risk management structure. Our fund's risk management plan requires excess insurance over what we consider a safe self-insurance retention which is $100,000 because of the size of the pool. We also cap our losses on an annual, aggregate basis but again we go back into the commercial market so that there has to be an availability of excess insurance to these groups to make them work. I think the gentleman from Middlesex pointed that out.

We think that if the bill that you're proposing here today is passed we can easily handle the $500,000. The large communities certainly can do it on their own and the smaller pools that are formed can carry the 100,000 or 200,000. There is a mechanism to form what we call "super-pools" which would insure each other and provide for the $500,000 in-house.

There was only one other point I would like to make and that is that at the present time we have -- we're experiencing a very serious reduction in the area of our excess liability insurance. Last year we were carrying $11 million in the north group and that was cut January 1st to $2,250,000. We were given -- and that was only on a temporary basis. We had -- one and a half million of that was provided, a capacity was provided for a 60-day period and the company has now taken that back. So we are down to $750,000 in both the north pool and the south pool as respects our excess insurance. And this is even though we have had an absolute pollution exclusion and so that has not made any impact whatsoever on the availability of the excess coverage to us. We've accepted that.

SENATOR LESNIAK: Of course the industry would say there's no such thing as an absolute pollution exclusion.

MR. VOZZA: Well, okay. But we have accepted the reduction in the limits of coverage and we have had very serious exclusions such as the sexual abuse and the absolute pollution.

SENATOR LESNIAK: And you need a bill like this to allow

you to carry on.

MR. VOZZA: And we need a bill like this.

SENATOR LESNIAK: Okay.

MR. VOZZA: Also, if I may just prevail upon the Committee slightly longer, we would urge--

SENATOR LESNIAK: You're prevailing upon me. The Committee didn't show you.

MR. VOZZA: We think if we can get this in place for July 1 it certainly is going to help offset what might be a crisis in the school area because most of their policies renew July 1.

SENATOR LESNIAK: Okay. I would suggest, I would recommend that you speak with Ted Reid from the School Boards Association -- he was here prior -- because they have not formed their policy yet vis-a-vis this legislation.

MR. VOZZA: There were two bills that were pending last year that would permit school boards to join existing municipal pools if they were within the district that was served by the pool. We think that that ought to be resurrected. It certainly could help. We're dealing with the same taxpayers in each community and certainly there are some real shockers that will be coming along come July 1. We think it's kind of important that they have that mechanism available to them.

SENATOR LESNIAK: Well, I'll look at that if you promise to talk to Ted Reid in terms of considering this legislation.

MR. VOZZA: I'll be glad to.

SENATOR LESNIAK: Thank you very much.

MR. VOZZA: Thank you.

SENATOR LESNIAK: Marlen Dooley, New Jersey Public Interest Research Group. Marlen, you're going to summarize your testimony for me, aren't you?

M A R L E N D O O L E Y: Summarize my three pages. My name is Marlen Dooley. I'm an advocate and attorney for the New Jersey Public Interest Research Group. New Jersey PIRG is testifying today in support of Senate Bill 1718. The

Environmental Lobby, which was unable to be at today's hearing, also endorses this bill and our statement.

As you're aware New Jersey PIRG has submitted testimony to the Environmental Impairment Liability Study Commission and testified before several Assembly and Senate committees on bills that propose solutions to different aspects of the insurance crisis. Our position has been and remains, that changes in the tort laws are not necessary and not in the best interests of the citizens of the State. New Jersey PIRG has rejected proposals to eliminate joint, strict and several liability standards. We also are opposed to caps and grants of immunity. We contend that the present problems are mainly due to insurance practices such as the cash flow underwriting process.

S-1718 suggests an approach which assists public entities to meet their responsibilities but does not do so at the expense of victim's rights or public safety. In fact, section 4(b) of the bill requires that the formula for determining the standard liability premium be based on exposure, compliance with the DEP, and claims experience. This rewards municipalities that have good claims records and creates incentive for other members to improve their operations. Many municipalities have complained at hearings that their premiums have risen dramatically despite their excellent claims histories. We've stated before that the insurance industry does a disservice to the public by using the cash flow underwriting process which does not correlate the amount of risk involved to premium. We applaud the bill's concern for safety and public welfare.

Our only suggestion at the present time is to amend section 2 of the bill. We feel strongly that one of the two State officials or employees on the Commission should be a member of the Public Advocate's office or someone appointed by that office. There's a clear public interest in knowing that adequate insurance coverage and proper premiums are set.

In conclusion I'd just like to say New Jersey PIRG supports S-1718 and we appreciate being given this time to

address the Commission.

SENATOR LESNIAK: Okay. We're going to have to take a look at your suggestion regarding someone from the Public Advocate's office. However, I would remind you that if the State is taken out of the bill, which I think they will be, we just may take the State officials off entirely. So who knows where we're going on that. Okay.

MS. DOOLEY: Okay. Thanks.

SENATOR LESNIAK: What goes is good for the goose is good for the gander. Lowell, I can't read your handwriting.

L O W E L L S E R H U S: Serhus is the name.

SENATOR LESNIAK: SBA, that could stand for a lot.

MR. SERHUS: No, it's Norwegian, S-e-r-h-u-s.

SENATOR LESNIAK: No, President of--

MR. SERHUS: Oh, SBA, Commercial Viking. SBA, Commercial Viking Insurance.

SENATOR LESNIAK: Okay. No prepared statement?

MR. SERHUS: No prepared statements.

SENATOR LESNIAK: Okay. Thank you for your testimony. No.

MR. SERHUS: I'll make it as brief as possible. Beat you to it.

SENATOR LESNIAK: Please. I don't want to rush you. It's just that I've been sitting here for three hours straight.

MR. SERHUS: No, no. I realize we've both been sitting here.

SENATOR LESNIAK: See, normally I would have one of my Committee members relieve me and I could take a five minute break.

MR. SERHUS: Would you like to take a five minute break?

SENATOR LESNIAK: But none of them are here. No. Go ahead.

MR. SERHUS: I prepared this text, actually, just the other day, and I was concerned about a number of elements as far as actually both bills that are being proposed.

SENATOR LESNIAK: Tell me a little bit about your business.

MR. SERHUS: Well, we have a small insurance firm that insures a number of public entities and--

SENATOR LESNIAK: Up to what amounts do you insure public entities generally?

MR. SERHUS: Well, taken from the primary coverage or we get involved in some self-insure type vehicles. The limits can be, depending on the size of the entity, could be 10, 15, 20 million dollars, up to --

SENATOR LESNIAK: You do provide that much coverage?

MR. SERHUS: Well, the entities that we have, the maximum we have in place now is $10 million to what the umbrella coverage.

SENATOR LESNIAK: You don't provide that amount of insurance?

MR. SERHUS: We're the agents for the insurance companies.

SENATOR LESNIAK: Okay.

MR. SERHUS: And at this point like I said there is a lot of, listening to all the comments, and I think the prime point that I want to make out is this: that I believe that the membership in this program is mandatory. Is that correct?

SENATOR LESNIAK: Yes.

MR. SERHUS: Does it cover workers' compensation?

SENATOR LESNIAK: No.

MR. SERHUS: It does not. We know that--

SENATOR LESNIAK: No problem then, right?

MR. SERHUS: No, no. There are serious problems facing the public entities. We know that. I think my view really as an individual here, and I don't represent any organizations except myself, is the free enterprise system, and I think as a taxpayer in the State of New Jersey and I think addressing the specific problems and the problems that created this particular crisis.

One area that I feel is very important and overlooked is

a risk management technique that I daresay about 95% of the public entities have not addressed and still aren't addressing and that is loss control. I will say that approximately 95% of the public entities do not have effective loss control programs or safety coordinators controlling those programs. You have a lot of losses that have been occurring and are going to occur because there is no control of those particular losses. The only way, again, to control any type of situation at all is to control the losses. I mean there's no other way to do it.

This is a risk management magazine. It's called "Business Insurance." It happens to be the March--

SENATOR LESNIAK: Get it every week.

MR. SERHUS: Pardon?

SENATOR LESNIAK: I get it every week. I don't say I read it.

MR. SERHUS: No, no. It's a good issue. So you have that loss control problem that is not being addressed properly and that concerns me deeply.

SENATOR LESNIAK: Is there an article there on loss control?

MR. SERHUS: No, this is the second segment and that has to do with the -- and it was mentioned before by Hazel Gluck -- the tort area. And I just want to read. This happens to be the excerpt from the Washington area. I'm going to cut it down. "And in other civil justice reform developments Senator Mitch McConnell, Republican of Kentucky, last week was--"

SENATOR LESNIAK: It's the same guy that we heard from before.

MR. SERHUS: I know. Well, you know, that's-- "was expected to ask the Senate--" .

SENATOR LESNIAK: This guy raises horses.

MR. SERHUS: He's down in Kentucky, too, right? "Was expected to ask the Senate to adopt the resolution urging overhaul the legal system at the state level. The resolution will say that it is the sense of the Senate that reform of the

civil justice system is urgently needed and that states should consider and adopt with all due speed measures designed to alleviate the liability crisis, the reform of their civil justice and tort law systems."

SENATOR LESNIAK: Is this guy a United States Senator?

MR. SERHUS: I believe he is, yes.

SENATOR LESNIAK: Send a message to him that he ought to worry about the Federal laws and we'll worry about the State laws. He'll tell me that we shouldn't pass resolutions telling them what to do. He's probably right.

MR. SERHUS: I'm just using the article as, I think, as a third party reference point. Another area is, and this is Senator Paul Simon, and Senator Simon recently said he would examine whether a federal reinsurance program would be established for businesses whose rates have gone up more than 100% in one year or that can't get coverage at any price.

SENATOR LESNIAK: These guys, these United States Senators are tying up reauthorization of the Superfund Law which is going to kill the people of the State of New Jersey. So I don't think too kindly of those two United States Senators who have been opposing -- those two particular ones -- who have been opposing reauthorization of reasonable and responsible limits to the Superfund which is hurting us in terms of this problem particularly in terms of environmental insurance, because we can't get these toxic waste sites cleaned up. So, you know, it's not a simple-- I kind of think you're getting at the point.

This isn't going to solve -- this bill isn't going to solve the entire problem. You have to look at the overall problem to give it--

MR. SERHUS: Well, I look at the pollution problem. It's a problem that is very difficult to solve and possibly, maybe that's the area that needs a program like this at this point. But let me just go on.

Les Creek, who is a -- Creek. I'm sorry, Vice President of Federal Affairs for Crum & Forster in Washington says, "A

Federal reinsurance program would be a disaster. Domestic and foreign professional reinsurers have a--" What?

SENATOR LESNIAK: We're not talking about reinsurance programs here. That's the next bill I'm going to reintroduce -- introduce.

MR. SERHUS: But I do think that it's tied into the fact that you had mentioned before that you would take some dollars and buy reinsurance coverage so that the taxpayers would not have to pay additional dollars if there was a debit based on negative claims experience. Hazel Gluck said the same thing -- credits or debits.

SENATOR LESNIAK: But we aren't going-- The State's not going to provide a reinsurance fund.

MR. SERHUS: No, but if I'm not mistaken in reading the bill, there's a provision made in there that you can go out and buy reinsurance coverage, correct?

SENATOR LESNIAK: Sure. Absolutely.

MR. SERHUS: That's why I felt that this was apropos.

SENATOR LESNIAK: How's that?

MR. SERHUS: You're dealing with the reinsurance market and I wanted to finish my -- the last paragraph.

SENATOR LESNIAK: Go ahead.

MR. SERHUS: He goes on that domestic and foreign professional reinsurers have abandoned certain lines and classes of business in North America because they have absorbed huge losses. Do you really believe that the Federal government totally lacking in casual reinsurance expertise could underwrite distressed lines that professional reinsurers have abandoned after decades of experience and make a small profit? As soon as Uncle Sam with his printing press becomes the reinsurer of last resort, no plaintiff will hesitate to press even the most spurious claim. Mr. Cheeks ends in his letter, "In essence such a plan would be like giving the keys of the United States Treasury to the organized plaintiff's bar."

Again, I'm using that as a reference point as far as

third party reference to the reinsurance part because it was addressed in your particular bill. I'm not supporting the plaintiff's bar or anyone else. That's, but that's-- And I feel that primarily that the free enterprise system is something that should be addressed more. I feel that there are programs out there. I don't know if all the effort has been taken to finding a viable vehicle. And I'm making a suggestion, before you start this State-run insurance company, and I don't think anyone wants a socialistic type program, and I think that's exactly what this is.

SENATOR LESNIAK: Well, then I guess we should do away this Social Security, Medicare, and Medicaid.

MR. SERHUS: Well, I think in this particular case it's a socialistic program where if the private enterprise system-- And I think with Social Security the private sector was not doing the job adequately. So I think Social Security came in.

SENATOR LESNIAK: That's the problem here, Lowell. You know, let me tell you something. I agree with you. I don't believe if private enterprise offered this coverage to public entities, we wouldn't (sic.) be sitting here this afternoon.

MR. SERHUS: That's correct.

SENATOR LESNIAK: And I do intend to look very closely at the suggestion of the League of Municipalities to have some kind of sunset or some kind of review after a couple of years to ensure that this isn't an ongoing bureaucracy when it's not necessary. This is designed to fulfill a purpose now and if we feel down the road it's not necessary, that the private enterprise can fill the void, I'll be the first one to offer legislation to abolish it.

MR. SERHUS: I think that what I'd like to propose is this. That the two top men in the State, Governor Kean and Senate President John Russo, appoint a panel and the panel to be comprised of a representative from the insurance company, an independent agency, business community, I think small and large, public entities, Insurance Department, and the Legislature, and

their prime task would be to look for the viable alternatives now. Give a set time, I took six--

SENATOR LESNIAK: I thought that was my job.

MR. SERHUS: All right. Fine. In six months if a viable vehicle is not found, then I think you should address, then I think you have a much -- a program that will work and a program that if a public entity cannot find insurance coverage, right, then the State should provide the coverage.

SENATOR LESNIAK: I have to do tell you that we have been studying it for the last six months and this is what we've come up with.

MR. SERHUS: But there are--

SENATOR LESNIAK: I don't see that there's any more expertise in that panel that you suggest than in this Committee or in the Commission that I headed and that six months more study is going to come up with anything. However, as I said, I am very open minded in terms of ensuring that when and if this is not needed -- and we all hope and expect that at some point in time, the sooner the better, this won't be needed -- then we'll abolish it.

MR. SERHUS: If an entity or the private sector could come forward within the next couple of weeks, obviously you would be very interested in--

SENATOR LESNIAK: Absolutely, absolutely.

MR. SERHUS: Okay.

SENATOR LESNIAK: Thank you.

MR. SERHUS: Thank you.

SENATOR LESNIAK: Wes Caldwell, American Insurance Association. Wes, you've got to call earlier to get up on the list.

W E S L E Y S. C A L D W E L L, III: I'm sorry, Senator. I just wanted to bat clean-up and go last, after all the others.

SENATOR LESNIAK: Well, you're not last. The Highway Authority is after you. Is George Mills still here?

G E O R G E M I L L S: I'm still here.

SENATOR LESNIAK: You're going to get a bottle of wine for being the last one.

MR. CALDWELL: Good afternoon, Senator Lesniak. I'm Wes Caldwell with the American Insurance Association. We represent about 175 companies that account for, I'd say, almost half of the general liability premiums written in New Jersey.

I apologize for not having a formal statement with me.

SENATOR LESNIAK: Don't apologize to me. I welcome you talking out.

MR. CALDWELL: On a bill like this, of this magnitude, I will certainly follow-up with more detailed material. But in looking it over, and I've only had it in my hands a few days, several things occurred to me. It seems to me that I think the bill is built on a couple of questionable premises. One is that the private market can't work and that the State, therefore, should step in.

SENATOR LESNIAK: That's true, by the way. I mean it's true that it's built on that.

MR. CALDWELL: That's your premise. Yes, and I think what was said earlier sheds a lot of light on that. The reason we don't have a MAP yet is because of the emergency regulation and the changes that have been discussed for many months and have now been published. Underwriters looking at that regulation were so fearful of taking on new business that the market for new business dried up. The regulation accomplished its purpose, which was to keep the companies on risks that were already out there, but any new business was virtuely unwritten since the regulation was adopted.

I think those changes, once they're adopted -- I think the industry will form an effective MAP and work with the Department and place these risks without difficulty. It's been done in other states. Another state that I deal with is New York. Their MAP is working very effectively. Last week at a meeting at the Insurance Department 24 companies signed up and agreed to take proportionate shares of the applications that are

submitted to the New York MAP and that afternoon they cleaned up the entire backlog of pending applications. I think there were 30 applications on the table, and by the end of the afternoon they were all written.

So I would expect the same thing to happen in New Jersey as soon as the reg is resolved and the companies sit down and begin looking at the applications and the companies, the municipalities you can't find--

SENATOR LESNIAK: If that's the case by the time this is ready to be signed into law we won't need it any more.

MR. CALDWELL: I would hope so.

SENATOR LESNIAK: So do I.

MR. CALDWELL: I think since the regulation was published this past Monday. I guess, with a minimum comment period of, I believe, 30 days, by early April that reg can be in place, the amended reg, and the MAP can be operating. In fact, I assume that between now and then, the mechanism will be put in place to have it up and running at the beginning of April.

Another premise of the bill seems to be that the State can effectively provide the insurance coverage.

SENATOR LESNIAK: True.

MR. CALDWELL: Every example we've seen around the country of state funds have proved failures. And it was mentioned earlier today, but look here in New Jersey at the--

SENATOR LESNIAK: Well, that was a primary insurance mechanism.

MR. CALDWELL: I don't think that makes a difference at all. I think what happens is, particularly when you're talking about what we call the long tail lines -- the liability lines where claims don't fully mature until maybe 15 years out, a good part of what has to be funded in the beginning is for losses that we call incurred but not reported. They're losses that the occurrences have happened but you don't know about the claim.

In the beginning when you're doing that, you have pretty large amounts you're putting away for what you expect to pay in

the future. If you have a State-run mechanism where there is political pressure on it to keep the assessment levels down--

SENATOR LESNIAK: Wes, I don't want to cut you short, so we're going to break for five minutes.

MR. CALDWELL: Sure.

(Recess)

SENATOR LESNIAK: Okay, we're back in session. Let's come to order. Okay, go ahead, Wes. Sorry.

MR. CALDWELL: Again, the point I was trying to make was whether the State can effectively provide an insurance mechanism and run one, and we haven't seen any examples anywhere that-- Well, there is one exception. New York has what we call a competitive state fund for workers' compensation. Instead of setting up an assigned risk plan like most states did years ago, New York as a matter of public policy said, "We'll set up a state insurance fund that will not only provide coverage as an insurer of last resort, but we'll go out there and actively compete for good business." And that fund has been fairly successful over the years, but it's not exclusive. In other states like Ohio where there is an exclusive state insurance fund for workers' comp it's been in deep financial trouble for many years.

Again, the problem is that the political pressures are put on the people that run those kinds of funds to keep the assessments or premiums down. And particularly when you're talking about very difficult and risky lines like municipal liability it would be very easy to under reserve and then when it finally -- when the claims finally mature through the pipeline 10 or 15 years out, you're talking about dramatic increases in assessments every year.

A good example here in New Jersey is some years ago the Legislature enacted a law to fund PIP claims under no fault policies above $75,000 and to fund them through the old unsatisfied claim and judgment fund. If you look at the numbers that are published by the unsatisfied claim and judgment fund every year you will see doublings of assessment levels. And the

reason for that is they do their assessments on a two-year analysis of claims. They don't project them out beyond two years. So what happens when that kind of a system catches up is big leaps in assessment levels.

The last point I'd like to make is that the premise seems to be that this bill will solve the problem.

SENATOR LESNIAK: Identify the problem.

MR. CALDWELL: Well, everybody is talking about the problem. There is a problem out there of municipality liability and liability in general.

SENATOR LESNIAK: Affordability and availability of public entity insurance.

MR. CALDWELL: Okay. We certainly agree with Commissioner Gluck that some effort to contain loss costs is essential. The areas that we think are most important to address have already been mentioned, joint and several liability. I think Peter hit on it before and didn't quite explain it in detail. One of the reasons why streets and roads is such a problem is that every time there's an accident and the defendant has 10/20 -- well, New Jersey is 15 and 30, $15,000 worth of coverage, but there is a serious injury that has maybe medical expenses far beyond that, it's very easy to bring a municipality into the suit. Very easy to allege that the lighting wasn't quite right, or the street wasn't constructed properly. They may ultimately only be found a very small percentage of responsibility but they will pay the entire judgment. Their insurance company will respond for everything above $15,000. That's one problem.

The other, we think it should be not an absolute cap on awards, but there should be a cap on the pain and suffering portion of awards. We think that economically everybody should be made whole, but the amounts that the courts have awarded for non-economic loss have been applied very arbitrarily. Some plaintiffs come away with big judgments and some come away with smaller judgments, but there should be some ceiling on the non-

economic loss portion.

SENATOR LESNIAK: You know I see the problem as -- Lesniak's philosophy: I don't think that the Appellate Courts are exercising their authority to review excessive verdicts. I think that is a problem.

MR. CALDWELL: That may be true. I don't know how you deal with that legislatively.

SENATOR LESNIAK: I don't know either. But I'm thinking.

MR. CALDWELL: The third area that we think is important and fair would be to deal with collateral sources of recovery. This is an area, particularly if you're talking about municipal governments where the public is the victim as well as the taxpayer, you should exclude from judgments the amounts that are recovered from other sources in terms of maybe workers' compensation coverage.

SENATOR LESNIAK: Well, that is. That is.

MR. CALDWELL: That is excluded?

SENATOR LESNIAK: Yes.

MR. CALDWELL: I don't think so.

SENATOR LESNIAK: There's a comp lien against any third party that's liable. Has to be paid back.

MR. CALDWELL: That's right, but that is not excluded from the judgment. No, you get your comp benefits. Then you go bring an action against a manufacturer, let's say, of a product in the workplace.

SENATOR LESNIAK: But the plaintiff doesn't get double recovery.

MR. CALDWELL: No, not in the comp example. But in, let's take an example where all of your medical expenses, let's say, are picked up by your employer's health insurance.

SENATOR LESNIAK: All right. That's an example.

MR. CALDWELL: One thing I'd like to clear up from what was said earlier--

SENATOR LESNIAK: By the way, I don't, quite frankly,

unless these guys fall off the chair in the back -- I don't see, I would agree with you. I mean if we do in PIP exclude that from evidence I don't see why we shouldn't do it in all instances.

MR. CALDWELL: I think it's a fair rule that should apply across-the-board.

Earlier today and I don't remember which--

SENATOR LESNIAK: Yes, exclude it in evidence if it's paid for by collateral source.

MR. CALDWELL: We go one step further. Right now the evidence rule says that you can't introduce evidence of the recovery. I'm saying just exclude it from the award after the jury makes a verdict.

SENATOR LESNIAK: Just ask me to do-- I went one step. You want me to take the mike off the plank entirely.

MR. CALDWELL: Well, I thought I'd give you something to work backwards from.

That could be a problem, too. If the Legislature gets involved in what really is a court rule of evidence. So I guess--

SENATOR LESNIAK: We did. We've done it with the PIP, with the no fault law. We did it with no fault.

MR. CALDWELL: You reversed the evidentiary rule in the no fault law as opposed to carving it out of the award?

SENATOR LESNIAK: Yes.

MR. CALDWELL: I'd have to go back and look at that.

SENATOR LESNIAK: That's in the no fault statute. Hum?

MR. CALDWELL: I'd have to go back and look at it. I don't recall the way it was done.

SENATOR LESNIAK: Oh, yes. Am I wrong? I don't think so. Are you going to be in Albany?

MR. CALDWELL: I'll be in Albany, yes.

SENATOR LESNIAK: We'll look it up and if I'm right you buy me a beer.

MR. CALDWELL: Okay.

SENATOR LESNIAK: Lunch, excuse me. Diet Coke.

MR. CALDWELL: I'll get you a non-alcoholic beer, how's that?

Earlier today there was some question about whether your fund is pre-emptive of the private market or not. We read it to be pre-emptive. And I think what you were talking about when you said the fund could either buy insurance or use the assessments it collects to provide the insurance.

SENATOR LESNIAK: Or self-insure.

MR. CALDWELL: I think what you're really talking about is that the fund may want to have reinsurance.

SENATOR LESNIAK: Right.

MR. CALDWELL: As an insurance entity, it may want to reinsure or lay off part of its exposure.

SENATOR LESNIAK: Right.

MR. CALDWELL: The problem, I think, that the fund will have is because of the history of state run funds around the country. I doubt very highly that the reinsurance market will be interested in providing coverage. I once worked for a reinsurer and what we're talking about here is what they call treaty reinsurance. It means that on an entire class of business, you have an agreement with another insurance company to take part of the exposure. In underwriting treaty reinsurance what they do is send in a team of auditors to look at the way the primary carrier writes the business, what kind of underwriting standards do they have, what kind of claims processing do they have? And if they trust the integrity of the primary insurer they will write a treaty for a portion of the reinsurance. Especially on a start-up state fund, I don't think that the reinsurance companies would trust it enough to come in and provice reinsurance for it.

So, in essence, what you would be doing under this bill, I think, is for that entire layer between $500,000 and 20 million it is pre-emoting the private market. A private market could still exist below it and above it, but not at that big level.

SENATOR LESNIAK: We're not pre-emoting it. They're deciding, making a business decision not to compete.

MR. CALDWELL: No, no. They won't be able to. The only way they would be able to compete is as reinsurers. Primary insurers would not be able to compete at that level.

SENATOR LESNIAK: No doubt about, I agree with you on that.

MR. CALDWELL: I think, and another part of that problem is if I read your bill correctly it includes the pollution exposure. Is that correct?

SENATOR LESNIAK: Yes.

MR. CALDWELL: We've seen figures from the EPA just on clean-up cost alone, in the range of $100 billion. The exposure for New Jersey's landfills for personal injury and property damage would, I think, be a staggering burden on this kind of a fund that would cause assessment levels to be extraordinarily high.

SENATOR LESNIAK: The Governor's office thinks that the claims are going to be very few.

MR. CALDWELL: They may be few tomorrow, but what they're going to be two, or five or ten years from now is a whole different story.

That's the essence of my comments. I'm going to provide you with some follow-up information and look forward to buying you a diet soda in Albany next week.

SENATOR LESNIAK: Okay. Now the Highway Authority is going to.

MR. MILLS: Thank you, Senator.

SENATOR LESNIAK: That's right, the Highway Authority. How come there aren't any other authorities here?

MR. MILLS: I really don't know, Senator.

SENATOR LESNIAK: How come only the Highway Authority is diligent?

MR. MILLS: I kept this very short as Bob Hunt covered a lot of the ground that I would have normally have covered. I'm just going to limit my comments to the last page plus one comment on the joint and several. We have the same problem that Mr. Hunt

does. We get hit with the big ones. We have paid out as high as two and a half million dollars on a single joint and several claim where our liability was listed at 2%. I have reserves now in similar situations which are much larger than two and a half million. Joint and several is a very, very serious and expensive problem for us.

SENATOR LESNIAK: Let me ask you this. In that case that you're talking about, would the accident have occurred but for your negligence?

MR. MILLS: I would feel that our negligence was de minimis. We had a man 85 who seemed to be practically blind in both eyes, couldn't hear out of either ear, went around the State Troopers who had the area coned and were directing traffic, cut around and pinned a man to the back of a truck and took both of his legs off. The judge, in his wisdom, said, "I do not feel that the State Troopers were doing all that they could have possibly done. If they had done everything possible the accident would not have happened."

SENATOR LESNIAK: Supposing a jury trial.

MR. MILLS: Wasn't on this -- before a judge. Jury was waived. Now we have--

SENATOR LESNIAK: Was tort claim.

MR. MILLS: Title 59 was in there.

SENATOR LESNIAK: I guess that's why.

MR. MILLS: And filed under it. We have others now where our carriers have reserved as high as 10 million.

SENATOR LESNIAK: Now, let me tell you something. If those are the judge's words, that the State Trooper did not do all that he possibly could have to avoid an accident, you take an appeal, because that's not the standard of negligence.

MR. MILLS: The insurance companies wouldn't go near an appeal. They were happy to get out with what they got out with.

SENATOR LESNIAK: I'll underwrite it --

MR. MILLS: Pardon me?

SENATOR LESNIAK: --if that's what the judge said.

because that's not the standard of negligence.

MR. MILLS: Well, we have the strong feeling that sociology was being practiced rather than the law.

SENATOR LESNIAK: Yes, but I don't know that the Appellate Division practices sociology the way the lower courts do, but anyway. You don't want to be in our pool anyway?

MR. MILLS: That's right. And we have--

SENATOR LESNIAK: You don't want to saddle the municipalities with your burdens.

MR. MILLS: We have serious questions as to whether or not it would be possible under our bonding resolutions.

SENATOR LESNIAK: Okay.

MR. MILLS: Our bonding resolutions seem to prevent such actions.

SENATOR LESNIAK: You're out.

MR. MILLS: Thank you very much. I appreciate it, Senator. It's been a pleasure.

SENATOR LESNIAK: Thank you very much for putting up with me. There will be another hearing.

(HEARING CONCLUDED)

APPENDIX

New Jersey State Library

Addendum: Testimony of William Rae, FIA & NJ

The sources of the information included in this report, in addition to my own research, are as follows:

The Hales Report - 1986

Insurance Information Institute Publications Service Center

Journal of American Insurance - 4th Quarter 1985

CPCU Journal - December 1985 Schmalz Article

Business Insurance

National Underwriter

Insurance Agent

Journal of Commerce

Travelers Monthly - The Protector Nov/Dec Issues

Forbes Magazine

Reinsurance Associates of America

IX

EXHIBIT

REINSURANCE ASSOCIATION OF AMERICA
Liability (Other than Automobile)--Excess of Loss Experience
(Excludes Asbestosis and Medical Malpractice Claims)

Accident Year	Development Period (Figures Shown in Millions)				
	12 Months	24 Months	36 Months	48 Months	60 Months
1980	$30.8	$ 83.4	$124.2	$171.7	$214.2
1981	$38.4	$ 98.1	$148.6	$199.5	
1982	$43.8	$101.3	$182.1		
1983	$36.2	$108.5			
1984	$45.4				

NOTE: Excess losses are 22% known after 5 years.

JMC,JR/dlf
02/27/86

2x

BOROUGH OF SPOTSWOOD

77 SUMMERHILL ROAD
SPOTSWOOD, N.J. 08884

RICHARD N. SHUSS
Business Administrator

(201) 251-0703

March 4, 1986

The Honorable Raymond J. Lesniak, Chairman
and Members of the Senate Labor, Industry
and Profession Committee
State House
Trenton, New Jersey 08625

Re: Senate 1718 - Excess Liability Commission

Dear Senator Lesniak and Committee Members:

The Borough of Spotswood is a small, suburban community in Central New Jersey, which is currently hard-pressed to provide basic services while landfill and insurance costs soar.

We want to bring to your attention what we believe to be a fairly typical problem. In our litigious society, no governmental entity can afford to be without adequate protection. Yet we are being forced to revise our definition of "adequate protection" since the cost has become way beyond our means.

Last year, we were insured for $1,000,000 general liability plus $5,000,000 excess coverage at a cost of about $21,000. This year basic liability has been reduced to $490,000 at a cost of $90,000 with no umbrella coverage at all! Our premium increased 428% for 1/12th of the coverage.

No carrier is willing to write an umbrella policy unless the first $1,000,000 is in place. To get to that first $1,000,000, we would need to purchase a "buffer policy" at a cost between $100,000 and $150,000. If we can then fill the $10,000 gap, excess insurance would start at $50,000 for the first million. So to get 1/3 of our 1985 coverage, our costs would approximate $265,000, a 1262% increase.

For a municipality with an annual budget of $3,000,000 and current total insurance expenditures exceeding $300,000, the increases are too foolish to consider.

3x

We are actively participating in the formation of an insurance pool in our County to jointly self-insure. But this plan depends on approval of a statewide excess insurance program, in place as soon as possible. We expect to have the pool up and running by June 1, 1986. So time is of the essence for all of us.

Thank you for initiating this landmark legislation and for allowing us this time to be heard.

Sincerely,

Richard N. Shuss

RNS/cc

4x

PARKER, REMSEN & SULLIVAN, INC.

Insurance

NEW BRUNSWICK PLAZA BUILDING • 303 GEORGE STREET

P. O. BOX 1116, NEW BRUNSWICK, NEW JERSEY 08903

AREA CODE 201 - 249-1200

January 21, 1986

Ms. Hazel Frank Gluck, Commissioner
State of New Jersey, Department of Insurance
201 East State Street
P.O. Box CN325
Trenton, New Jersey 08625

Re: Borough of Spotswood
General Liability and Umbrella Insurance

Dear Ms. Gluck:

I am writing to you on behalf of the above referenced client.

We have finally received the renewal General Liability quotation from the Hartford. For a limit of $490,000. the premium will be $89,600. This is 51% less coverage for 5½ times the expiring premium.

We have been informed that due to this change in the primary limits, not only will Integrity, the Umbrella carrier, not have to renew, but they will also not have to resend a valid notice of non-renewal.

I am calling these items to your attention due to the fact that apparently these are the arrangements made between the companies and the Department of Insurance and of which no one was informed until after the fact.

As a result of the above, I am now faced with the situation of $490,000. of coverage for the 86-87 year when the coverage I had for the 85-86 year was $6,000,000.

As there are no carriers presently writing Umbrella Liability insurance for muicipalities with less than $1,000,000. of primary insurance, I must first purchase a buffer between the $490,000. and $1,000,000. that will cost between $100,000. and $150,000. annually and also leave me with a gap of $10,000. as the company will only write $500,000. excess of $500,000.

Then I can try to buy an Umbrella policy which will probably cost at least $50,000. for the first million.

How can the Borough afford to pay these premiums and not eliminate most of its services to meet the 5% cap on budget increases? Please be aware that all of the other coverages for the Borough increased 100%

5%

or more with the exception of the Worker's Compensation.

Neither our client nor our firm can understand at this point how the regulations now in force are helping us.

Virtually, all competition has been eliminated due to the fact that most major carriers are closed for business. Some of the other carriers open are in such shaky financial positions that we cannot afford to place business with them. The other admitted and non-admitted carriers that are open are charging such exhorbitant premiums that they are beginning to put firms out of business or causing others to reduce their operations to the point that they will be out of business.

Granted, this is not the case for all commercial business. For the most part though, businesses with large enough premiums are experiencing difficulty in renewing their policies at premiums that are not causing financial hardship. Also, it means that the consumer will wind up footing for the bills either through higher prices or loss of services.

Is there no other way to control the chaotic state of our industry? From where I sit, it appears that we have not even seen the worst yet.

If there is anything you can do to force Intergrity to renew over the primary and/or Hartford to increase the primary, our firm and our client would be most appreciative.

Very truly yours,

PARKER, REMSEN & SULLIVAN, INC.

Maureen O'Neill Brown
Commercial Insurance Manager

MONB/ck

cc: Richard Schuss, Business Administrator, Borough of Spotswood
William Doyle, Executive Vice President, IIANJ

6X

TESTIMONY
NEW JERSEY STATE SENATE HEARING
BILL S-1718

by

JOSEPH L. VOZZA
EXECUTIVE DIRECTOR/ADMINISTRATOR

for

BERGEN COUNTY MUNICIPAL JOINT INSURANCE FUND
SOUTH BERGEN MUNICIPAL JOINT INSURANCE FUND
BERGEN COUNTY

One Depot Square
Park Ridge, N.J. 07656

March 5, 1986

7x

EXECUTIVE SUMMARY

.Funds represent 39 Bergen County Municipalities

.Problem: Coverage Unavailable at any cost and reduced to $750,000 from $11 million.

.Premium increased from $747,000 to $1,355,000

.Claim experience excellent

.Time table critical because many towns "bare" and problem will be compounded when school board policies come due for renewal

.Savings for these Self-Insurance Funds estimated at $800,000

.Position: Strongly favors formation of Intergovernmental Excess Liability Commission

8x

TESTIMONY - SENATORIAL HEARING - BILL S-1718

I am here today to testify in my capacity as the Executive Director/Administrator of New Jersey's first two Municipal Self Insurance Funds — Bergen County Municipal Joint Insurance Fund and South Bergen Municipal Joint Insurance Fund. The first began operations effective Jan. 1, 1985 and the other the beginning of this year.

In addition, I have been in the business of Risk Management since 1948 and before helping to organize these Funds, I was president of a group known as Governmental Risk Management Corp. which specialized in placing coverage for school boards and municipalities.

Obviously, there is a genuine concern over the cost and availability of excess liability coverage. I have already been called upon to explain our self-insurance program to municipalities in Atlantic, Sussex, Ocean, Essex and Hudson Counties, all of whom have expressed interest in following Bergen's lead.

Collectively, the Joint Insurance Fund presently provides protection for 39 of Bergen's 70 municipalities and the membership continues to grow. These Funds are self-insurance pools as permitted under P.L. 372, supplementing Title 40A. The regulations governing the operation of municipal pooling were well written and foster an actuarily sound and properly funded program. To maintain the integrity of these pools; however, it is essential that we have available excess insurance over the pool's Self Insured Retention (SIR).

The Fund's Risk Management Plan caps losses two ways. First, our excess liability insurance protects the Fund against the effects of a single catastrophic loss. In effect, we purchase a policy with a large deductible that all members share. For example, if a member had a $500,000 loss the Fund would pay $100,000 and the excess insurance company would pay $400,000.

The second way we cap our losses, to properly budget our potential liability, is to provide a ceiling on the maximum payouts the Fund can be called upon to make in any given year. This is called an "annual aggregate".

When we started in Jan. 1985, we were able to secure $11 million liability coverage excess of the Fund's $100,000 SIR. Some members purchased coverage excess of the $11 million on their own. One member, for example, purchased $9 million excess of the Fund's $11 million.

The Fund started with 16 municipalities which grew to 25 by year's end. We paid $595,000 in premiums. To date, our insurance companies have paid nothing and if the one pending claim (reserved for $68,000) were paid, we would have a loss/ratio of only 11.4%.

In addition, since our total losses for 1985 (reviewed as of Feb. 1986) were only 71% of our annual aggregate cap, it appears unlikely that the insurance company would have to pay out anything in this area.

Even with this excellent loss experience, we had to increase our insurance budget from an annualized 1985 premium of $747,000 to $1,355,000. Of even greater concern is the fact that our broker has not been able to complete his placement of our excess auto, general and police liability coverage, and what he did get contains several exclusions that were not in last year's coverage.

In January of this year, all he could get us was $2,250,000 with $1.5 million capacity arranged on a temporary basis ---- and the company that giveth has now decided to taketh away.

Effective March 1, our excess liability limit has been reduced to $750,000 and of course, members with coverage excess of the Fund's, such as the one with the $9 million, lost their excess since the companies providing it would not come in over the Fund's reduced limits.

Clearly, we are not talking about a group of high risk towns with poor experience, but rather 39 communities with <u>good</u> experience. Over the past six years, the single largest claim was a fatality involving a fire truck which was settled for $350,000. Bottom line is that even though none of these 39 towns have had any excess liability claims, they could not get this coverage.

11x

Something is terribly wrong -- but perhaps this is the subject for another forum. The problem we must face today are the many ticking time bombs out there and an industry that either cannot or will not provide for the needs of the insuring public. While normally I am not an advocate of enlarged government, I believe that when an industry demonstrates its inability to perform, then government has an obligation to act.

I believe S-1718 represents a major step toward getting the job done. Many of the larger units of government can retain the first $500,000 of any liability. Smaller units can form Self Insurance pools and small pools can join "Super Pools" designed to insure each other, thus insulating for the future all units of government from the cyclical swings they have been forced to endure every decade for the past 40 years.

Our insurance budget for both Bergen Funds exceeds $2.2 million. Approximately $1.5 million is for excess liability insurance. It is estimated that we could expect a savings of about $800,000 if the Inter-governmental Excess Liability Commission is created.

I also believe that this legislation may well become a prototype for the rest of the nation. If coupled with Tort Reform, particularly in the area of "Joint and Several" liability, we might even make history.

Time grows short. I urge speedy approval of this bill so that the commission can be in place by July 1 when most school board policies renew as this may well be our next crisis.

12x

QUESTIONS/SUGGESTIONS

.Page 1: The definition of the date of an event appears to provide retroactive coverage. Is this a proper interpretation of the intent of the Act?

.Page 2: (End of Section C) Units of government should be allowed to join an existing joint insurance fund.

.Page 3: Is the limit $10 million or $20 million?

13x

NJPIRG

204 West State St.
Trenton, NJ
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(609) 393-7474

NEW JERSEY SENATE

LABOR, INDUSTRY AND PROFESSIONS COMMITTEE

STATEMENT IN SUPPORT OF S-1718

THE NEW JERSEY PUBLIC INTEREST RESEARCH GROUP

Marlen Dooley, Esq.

March 5, 1986

14x

My name is Marlen Dooley. I am an advocate and attorney for the New Jersey Public Interest Research Group (NJPIRG). NJPIRG is a statewide, non-profit, non-partisan group that works in the areas of environmental preservation, consumer protection and corporate and governmental accountability on behalf of its 63,000 members.

NJPIRG is testifying today in support of Senate bill 1718. The Environmental Lobby, which was unable to be at today's hearing, also endorses this bill and our statement.

NJPIRG has submitted testimony to the Environmental Impairment Liability Study Commission and testified before several Assembly and Senate Committees on bills that proposed solutions to different aspects of the "insurance crisis" (A-2545; S-3206; S-3423). Our position has been and remains that changes in the tort laws are not necessary and are not in the best interest of the citizens of this state. This bill is the only reasonable alternative, as yet offered, to the insurance companies proposals. Because there continues to be misinformation that limits on liability are pro-consumer, I have briefly expanded upon our position.

We contend that the "insurance crisis" is a manufactured one, due to the cyclical nature of the insurance industry. Companies cut their prices when interest rates, and thus their income from investing the premiums they collect, are high; they raise their prices when interest rates, and thus investment income are low. This cash flow underwriting process is evident from the figures of the U.S. Government Accounting Office study for 1974-1983. Property/casualty insurance companies had underwriting losses of 28 billion dollars, but investment gains of 100 billion dollars were realized. The net gain was 72 billion dollars.

We have witnessed the rising of premiums and the simultaneous demands on the legislature before. Robert Hunter, president of the National Insurance Consumer Organization, in testimony before the federal subcommittee on Commerce, Transportation and Tourism, stated that when he was Federal Insurance Administrator, malpractice insurance premiums skyrocketed. Federal Government

investigations found the crisis to be unwarranted, but half the states nevertheless reduced victims' rights in malpractice cases. And, in 1960, insurance companies refused to insure inner cities that were likely to incur damage during the rioting. In that case, the federal government became a reinsuror and made 125 million dollars.

Insurors claim that they are withdrawing from the market, because they can not make a profit writing insurance. As mentioned above, property/casualty insurance companies had a net gain of 72 billion dollars in 1974-1983. The industry made a profit of at least 1.7 billion dollars in 1985. In addition, Best's Property/Casualty Stock Index indicates that insurance stocks have continuously outperformed the Dow Jones index over the last five years. Between 1980 and 1985, property/casualty stocks increased 194% versus 84% for all stocks on the Dow Jones index. During 1985, the industry's net worth rose by 7.6 billion dollars.

NJPIRG believes that the present tort law is valuable and should not be changed upon insuror demands. Responsible parties should bear the cost of correcting problems that they have caused or allowed to happen. Joint and several liability means that a wrongdoer is accountable for the damage he causes, and it is no defense that another wrongdoer may have also been at fault. Abolition of joint and several liability would tilt the scales in favor of polluters and against citizens who sue them.

Strict liability standards ensure that the highest standard of care is used. By requiring those who perform dangerous activities to be absolutely responsible for damages, regardless of fault, every precaution will be taken to insure that an accident does not occur. NJPIRG is also opposed to caps and legislative grants of immunity to responsible parties. These measures would limit or eliminate a victim's ability to sue for legitimate claims.

S-1718 suggests an approach which assists public entities to meet their responsiblities, but does not do so at the expense of victims' rights or public safety. In fact, section

4b of the bill requires that the formula for determining the standard liability premium be based on exposure, compliance with the Department of Environmental Protection and claims experience. This rewards municipalities that have good claims records and creates an incentive for other members to improve their operations. Many municipalities have complained at hearings that their premiums have risen dramatically, despite their excellent claims histories. The insurance industry does a disservice to the public by using the cash flow underwriting process, which does not correlate the amount of risk involved to premium. We applaud the bill's concern for safety and public welfare.

Our only suggestion, at the present time, is to amend section 2 of the bill. We feel strongly that one of the two state officials or employees on the commission should be a member of the Public Advocate's office or someone appointed by that office. There is a clear public interest in knowing that adequate insurance coverage and proper premiums are set.

Conclusion

NJPIRG supports S-1718. It is a responsible solution to the insurance problems being faced by public entitites. It will not reduce victims' rights or public safety measures. The formula for setting premiums will,in fact, promote safety and responsible actions in government activities.

17x

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

SUBMITTED TO

THE NEW JERSEY SENATE LABOR, INDUSTRY AND PROFESSIONS COMMITTEE

CONCERNING

MUNICIPAL LIABILITY INSURANCE
(SENATE BILL 1718)

March 5, 1986
Trenton, New Jersey

American Insurance Association

The American Insurance Association is a national trade organization of casualty insurers.

18x

PROFILE

The American Insurance Association is a full-service trade organization of casualty insurance companies. In its present form, the association combines three earlier organizations. One of those, the former National Board of Fire Underwriters, was organized in 1866, making it one of the oldest trade associations in the nation.

The various departments provide members with up-to-date intelligence on legislative, regulatory, judicial and technical developments relating to our industry. The AIA also maintains liaison with insurance regulators, federal and state lawmakers, other state and federal government officials, insurance and non-insurance industry groups and media—supplying information and assistance on issues of mutual concern.

A countrywide system of regional offices and local legislative counsel ensures prompt and rigorous attention to casualty insurance matters. At the same time, technical specialists from disciplines as diverse as law, economics and engineering educate members and outside publics on developments that may affect the industry and its services to the insurance-buying public.

Good morning. I'm Wes Caldwell, a Vice President for Government Affairs with the American Insurance Association. AIA represents more than 170 property and casualty insurers that account for over 45 percent of the general liability premiums written in New Jersey and a majority of the municipal liability premiums in this State. Our members have a vital interest in the markets for municipal and school district liability, and we appreciate the opportunity to be here today to provide you with our views.

OVERVIEW

Before any discussion of today's market for municipal liability insurance, a discussion of its history may be helpful. First, there are a couple of long-range trends affecting this market that cannot be ignored. One has been a continued expansion of liability concepts--a trend that has grown for decades, and has accelerated in recent years. As a result of ever-increasing expectations on the part of the public for compensation whenever there is an injury, courts have created new kinds of liability and new theories of liability that were unknown thirty or forty years ago. Municipal liability is a perfect example. It was not too long ago that the doctrine of sovereign immunity prevailed throughout this country. Because of their special status in serving the public good, governments were once immune from suit. Compensation for injuries caused by government was solely an act of legislative grace. Other important examples of new liabilities include product liability and environmental liability. Similarly, new theories of liability like strict liability (liability without fault), have enabled broad new classes of plaintiffs to recover in instances where liability previously could not be established. For much of the past, of course, this long-range

trend was not harmful to the casualty insurance industry. Our industry grew and prospered as expanded liability concepts created new markets for insurance products, which in turn attracted new capital to fuel the industry's growth. But perpetual growth is like a Ponzi scheme--at some point, the bubble bursts. When the costs of new liabilities exceed the ability of insureds to pay for coverage, there are fundamental problems. When new liabilities expand in ways that make coverage impossible for insurers to price, the system should be reexamined.

A related long-term trend affecting liability markets is the cyclical nature of property and casualty insurance industry growth, profitability, and pricing patterns. While liability concepts and demands for coverage have expanded generally leading to the industry's long-range growth, inevitable short-range economic trends have led to up and down cycles. Traditionally, these cycles have lasted about four years. Just as demand for insurance is influenced by the general health of the nation's economy, supply is influenced by other basic economic trends. Supply or capacity in our industry is directly related to insurer surplus, the uncommitted funds that stand behind the liabilities undertaken by insurers. The volume of premiums that safely can be written by an insurer is viewed by regulators and managers alike as a multiple of surplus. The normal rule of thumb is a ratio of two dollars in premiums written for every dollar of surplus. The amount of surplus in the industry is affected by factors like underwriting losses or profits that expand or contract surplus, the health of the stockmarket, which affects the

value of surplus investments, and by the amount of new capital flowing into the industry. When insurance prices are at the high point of the cycle, new capital is drawn to the industry, which leads to price cutting because of the expanded supply. Eventually, lower prices lead to underwriting losses, which impact negatively on surplus and discourage capital inflow. This reduction of supply in turn leads to a firming of prices and completion of the normal cycle.

Against the backdrop of these long-range trends, there are recent trends that have made the current market cycle different from others in the past. Our industry is just beginning to emerge from the longest down cycle in recent memory. Abnormally high interest rates in the late 1970s brought substantial inflows of new capital to the property and casualty industry. Vigorous competition for market share lead to "cash-flow" underwriting whereby insurers were willing to accept underwriting losses in anticipation of high levels of investment income on loss reserves that would produce a bottom-line profit. This volatile competition and cash-flow underwriting were especially evident on "long-tail" coverages like municipal liability where many claims are paid out years after the premiums are collected. The high interest rates of the late 1970s, however, did not continue, and underwriting losses turned into net losses after accounting for investment income.

An unbroken string of underwriting losses began in 1979 and grew at an average annual rate of $3 billion through 1983. In 1984, underwriting losses jumped $8 billion to $21.3 billion. Underwriting losses for the six years

1979 through 1984 totalled $55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income--the combination of investment income and underwriting results--plunged to a negative $3.8 billion in 1984. The experience on commercial liability lines has been particularly negative, and the loss experience on general liability, (which includes municipal liability) leads all lines of insurance. For general liability insurance in 1984, the overall industry combined ratio (losses and expenses divided by premiums) was 152. This means that the industry paid out a $1.52 in losses for every dollar in premiums collected. The Insurance Services Office has estimated that the capacity shortfall will be $7.2 billion or 5 percent of the market in 1985, $22.6 billion or 14 percent of the market in 1986, and $32 billion or 18 percent of the market in 1987. Due to an unexpected influx of new capital in the last quarter of 1984 and the first half of 1985, ISO is now revising its estimate of the capacity shortfall downward, but the capacity problem remains a significant one.

During the same period of mounting losses in the property and casualty industry, several other recent trends have combined to make insurance underwriters more cautious about writing municipal liability and other troublesome liability lines. One has been an explosive growth in suits and judgments against municipalities and a resulting effect on settlements. In their quest for the "deep pocket," plaintiffs' attorneys have increasingly named municipal governments as additional defendants in law suits brought primarily against others. Municipal officials are well aware of the trend to

name municipalities as additional defendants in many actions involving traffic accidents on public highways or in actions where government services might be remotely involved. And, under principles of joint and several liability, if the prime defendant has little or no insurance protection, the municipality's liability insurance policy can be called on to pay most or all of the judgment. In any event, defense costs can be considerable today even if a municipal defendant prevails. A related trend toward very large jury awards with its impact on settlements has exacerbated this situation. Finally, there has been a disturbing trend throughout the country in recent years of expanded judicial interpretations of insurance contract language far beyond that intended by the parties. A recent New Jersey decision, for example, interpreted a standard clause limiting pollution coverage to "sudden and accidental" events as providing coverage for gradual seepage at a municipal landfill over a period of many years. These trends in the civil justice system have made municipal and other liability lines extremely difficult for insurance underwriters to price, and have caused some insurers to abandon these markets to devote their reduced surpluses to lines of insurance that are more stable and predictable. Reinsurers, which ultimately bear a major portion of the financial risks undertaken by insurers, have also cut back on or abandoned U.S. commercial markets as a result of large losses and their perception of a civil justice system gone haywire.

What is the market like today for municipal liability insurance? Certainly, in this era of shrunken capacity and cautious underwriting,

municipal liability coverage is much more difficult to find, and shopping around for a bargain basement price is no longer a common option. But to our knowledge, coverage is available in most parts of the country at significant price increases over the inadequate levels of the last few years. The agent or broker who placed a municipality's coverage last year may no longer have that market available to him, but there are other producers out there who can place the coverage. The experience of the Market Assistance Program recently established by our industry under the auspices of the New York Insurance Department seems to bear this out. The necessary price increases on this line of coverage, of course, have created particular problems for government entities. The substantial price drops over the past six years may have been a boon in an era of tight municipal budgets and scarce local resources, but the annual budget process cannot adjust as well to the first year of substantial and unanticipated price increases. This year's premium quotation, however, should not be compared with 1984's premium level at the bottom of the cycle; rather this year's premium should be compared to prices paid in 1979 or 1980. On average, 1985 premiums are not significantly higher than those of five years ago.

In New Jersey, availability problems have been intensified by the Governor's emergency regulation, promulgated last fall. This well-intended measure was designed to protect insureds against unwarranted cancellations and nonrenewals, and it has accomplished that purpose. But the regulation is so restrictive that underwriters have been very reluctant to write any new

policies, which would be subject to the new restrictions. In short, in an era of restricted capacity, insurers allocate available capital to jurisdictions with more reasonable regulatory climates. The Department of Insurance has proposed amendments to the regulation that would provide a more balanced approach to the problem of unfair cancellations and nonrenewals. If these amendments are adopted, we would expect availability problems to ease.

What should be done about today's problems in the municipal liability insurance market? Our industry has attempted to deal with problems of availability on municipal and other liability lines in at least two ways. First, we have been working with insurance regulators throughout the country to establish Market Assistance Programs on liability lines that are experiencing availability problems. Under a MAP, committees of insurance producers and insurance underwriters seek to place coverage in the voluntary market on behalf of any applicant submitted to the MAP. During the last upturn in the insurance cycle in the 70s, MAPs for municipal liability and product liability proved highly successful. We would expect to see such MAPs established in New Jersey once the problems created by the emergency regulation are resolved.

Another thing our industry is doing to improve the municipal insurance market is working to develop strong new contractual language that should prove less susceptible to unexpected judicial expansion and should increase the predictability of losses and the ability of underwriters to price coverage. Pollution liability, for example, which is uninsurable under current law and

scientific knowledge, will be excluded from policy forms recently approved by the Department of Insurance. Social and economic difficulties have combined with scientific and tort liability problems to make these risks uninsurable. According to government studies, all landfills and hazardous dump sites leak. Thus, from an insurance underwriting standpoint, the question is not risk of loss but rather certainty of loss. Absent prompt an effective cleanup operations for all of these sites, (a formidable if not impossible task), current scientific knowledge tells us that persons and property will be harmed. Who will be harmed, when they will be harmed, and the extent of the harm (and its resultant costs) is not known. Moreover, under state and federal laws, owners, operators, and others are held strictly liable (without regard to fault) on a joint and several basis. The problem is a social and economic one not susceptible to a solution through the insurance mechanism alone, and the magnitude of this problem is such that the financial resources of the entire property and casualty insurance industry would be insufficient to absorb the costs under current projections.

In another effort to improve insurance contracts, the Insurance Services Office has developed and is seeking approval of new claims-made forms throughout the country, which will reduce pricing uncertainty on long-tail coverage lines. Under these forms, coverage will be provided for claims made during the policy year rather than for events occurring during that policy year that might produce claims many years later. This change to a claims-made policy will substantially reduce the lag in claims payment and the time

period during which loss reserves are held subject to fluctuations in investment returns, both of which in turn will increase the accuracy of insurance pricing. The New Jersey Insurance Department is reviewing the new ISO form.

Finally, our industry is working with government officials and legislators in an educational process focused on the need to reduce loss costs. Regardless of how municipal liability protection is provided--whether through self-insurance or an independent insurance mechanism--a root cause of the long-range problem is the ever-increasing cost of losses. Regardless of one's views in the debate over tort reform on other lines of insurance like medical malpractice or product liability, we believe there is a strong case for taking a separate look at the liability of government entities. It's easy to say that the public's right to sue doctors or businesses for their injuries should not be curtailed to benefit a special class of defendants, but in the case of governmental liability, the rights to be balanced are those of the members of the public who sustain injury and those same members of the public who pay taxes. In this sense, the municipal liability reform debate is more analogous to no-fault auto insurance reform, where the Legislature balanced the rights of injured motorists and the costs of all motorists paying auto insurance premiums.

In summary, we believe strongly that every effort must be made to allow the municipal liability insurance market to regain its health through voluntary approaches like the MAP and through a fundamental reexamination of

the civil liability rules that should apply to government entities. In terms of cost savings, the most significant reforms that should be examined by the Legislature in our view are apportioned liability, a limitation on awards for noneconomic losses, and a strong state-of-the-art defense. We stand ready to work with municipal officials and the Legislature in developing and advocating appropriate civil justice reform proposals for government entities in New Jersey.

New Jersey Senate Bill 1718 is, in our views, a misguided solution to the municipal liability problem. The bill would address the problem by establishing an exclusive state fund to provide excess liability coverage for local government entities. The fund would provide excess coverage for liabilities over $500,000 and up to an aggregate limit of $20 million. The bill is grounded in several underlying assumptions with which we must disagree.

The first questionable assumption is that the state must enter the municipal insurance market because the private marketplace can't work. As we noted earlier, we believe that the private market can and will work in New Jersey once our industry is able to establish a Market Assistance Program under the auspices of the New Jersey Insurance Department. Once appropriate amendments to the emergency regulation on cancellation and nonrenewal are adopted, we expect a workable MAP to follow. There is no reason to preempt the private insurance market from the municipal excess liability field.

The second faulty assumption is that the state can successfully establish and run an excess liability insurance fund. There is strong evidence to the contrary. Political pressures inevitably lead to inadequate rates for state-run insurance mechanisms. New Jersey's joint underwriting association for medical liability reinsurance, which was deactivated a couple of years ago, built up a deficit of over $50 million due to the inadequate rate levels approved by the Department of Insurance while it was in operation. New Jersey's Automobile Full Insurance Underwriting Association, which has only been operational for a couple of years, has already built up a large, unfunded liability that will have to be paid eventually by a surcharge on all New Jersey auto policyholders. Moreover, in each of these instances, insurers had responsibility for administering the mechanisms and fought with the Department for higher rate levels. Under this bill, the Commissioner of Insurance would simply establish the assessment levels to be charged municipal governments. The municipalities will hardly pressure the state for higher assessments, and there is no reason to believe that the state will be any better at establishing adequate rate levels when there is no one interested in challenging those determinations. The fact that this fund would insure pollution liability, which we consider uninsurable under current law, will only exacerbate and hasten the inevitable financial problems.

The last questionable assumption underlying Senate 1718 is that the bill will solve the municipal liability problem. We disagree. This bill, if enacted, would make excess liability insurance readily available to all New

Jersey municipalities. But the real problem, as we have noted, is not an insurance availability problem, but rather it is a liability cost problem. This bill would do nothing to limit the rapidly escalating costs of municipal liability. Inadequate rates may hide that problem for a while, but eventually assessment levels will begin to grow by leaps and bounds even under a cash-flow system. At that point, the Legislature will have no choice but to address the real problem of how to limit municipal liability costs.

Thank you again for the opportunity to be here today to present the views of our members. I would be pleased to answer any questions you may have or to follow up with any additional information you may desire.

Respectfully submitted,

AMERICAN INSURANCE ASSOCIATION

Wesley S. Caldwell, III
Vice President
New York/New Jersey Region

GENERAL LIABILITY INSURANCE
MUNICIPAL CLASSES
MONOLINE AND PACKAGE BUSINESS

POLICY YEAR ENDING	TOTAL LIMITS EARNED PEMIUMS	DEVELOPED BASIC LIMITS INC. LOSSES	DEVELOPED EXCESS LIMITS INC. LOSSES	NUMBER OF CLAIMS	T/L LOSS RATIO
NEW JERSEY					
31-Dec-80	553,353	1,596,639	824,512	208	4.375
31-Dec-81	944,841	2,418,001	991,713	332	3.609
31-Dec-82	913,065	2,509,835	296,540	342	3.074
31-Dec-83	1,523,143	4,408,068	726,191	604	3.371
31-Dec-84	1,514,103	4,742,685	296,545	724	3.328
TOTAL	5,448,505	15,675,229	3,135,501	2,210	3.452
COUNTRYWIDE					
31-Dec-80	17,564,225	19,678,560	8,424,598	3,039	1.600
31-Dec-81	36,486,980	36,313,768	20,871,103	5,055	1.567
31-Dec-82	50,807,140	53,552,190	28,291,108	7,094	1.611
31-Dec-83	59,527,190	77,119,739	52,352,646	9,848	2.175
31-Dec-84	53,282,896	85,481,588	51,932,731	10,519	2.579
TOTAL	217,668,431	272,145,845	161,872,186	35,555	1.994

Losses are developed and adjusted for allocated LAE.

GENERAL LIABILITY INSURANCE
GOVERNMENTAL SUBDIVISIONS(CLASSES 91250-91263)
MONOLINE AND PACKAGE BUSINESS

POLICY YEAR ENDING	TOTAL LIMITS EARNED PREMIUMS	DEVELOPED BASIC LIMIT INC. LOSSES	DEVELOPED EXCESS LIMIT INC. LOSSES	NUMBER OF CLAIMS	T/L LOSS RATIO
NEW JERSEY					
31-Dec-81	2,378	10,782	0	4	4.534
31-Dec-82	14,067	105,814	0	20	7.522
31-Dec-83	25,661	146,268	0	22	5.700
31-Dec-84	104,038	380,733	0	75	3.660
TOTAL	146,144	643,597	0	121	4.404
COUNTRYWIDE					
31-Dec-81	13,966,938	7,951,868	6,688,880	900	1.048
31-Dec-82	26,561,019	18,290,812	10,291,954	2,286	1.076
31-Dec-83	29,064,201	25,033,005	15,552,704	3,142	1.396
31-Dec-84	25,970,257	30,952,288	21,040,198	3,690	2.002
TOTAL	95,562,415	82,227,973	53,573,737	10,018	1.421

Losses are developed and adjusted for unallocated LAE

33X

GENERAL LIABILITY INSURANCE
PUBLIC SCHOOLS (CLASSES 82113 & 93221)
MONOLINE AND PACKAGE BUSINESS

POLICY YEAR ENDING	TOTAL LIMITS EARNED PREMIUMS	DEVELOPED BASIC LIMIT INC. LOSSES	DEVELOPED EXCESS LIMIT INC. LOSSES	NUMBER OF CLAIMS	T/L LOSS RATIO
NEW JERSEY					
31-Dec-80	390,857	812,783	81,531	134	2.288
31-Dec-81	625,989	1,169,650	131,227	191	2.078
31-Dec-82	594,835	1,508,309	254,315	222	2.963
31-Dec-83	1,179,398	2,844,309	624,241	397	2.941
31-Dec-84	1,132,368	3,207,926	250,191	465	3.054
TOTAL	3,923,447	9,542,978	1,341,505	1,409	2.774
COUNTRYWIDE					
31-Dec-80	10,899,798	9,937,374	3,508,846	1,735	1.234
31-Dec-81	15,233,173	14,292,633	6,412,655	2,502	1.359
31-Dec-82	17,046,915	18,466,421	6,085,288	2,978	1.440
31-Dec-83	23,898,414	35,065,905	21,139,511	4,771	2.352
31-Dec-84	21,754,274	38,084,706	19,349,594	4,967	2.640
TOTAL	88,832,574	115,847,039	56,495,894	16,953	1.940

Losses are developed and adjusted for unallocated LAE

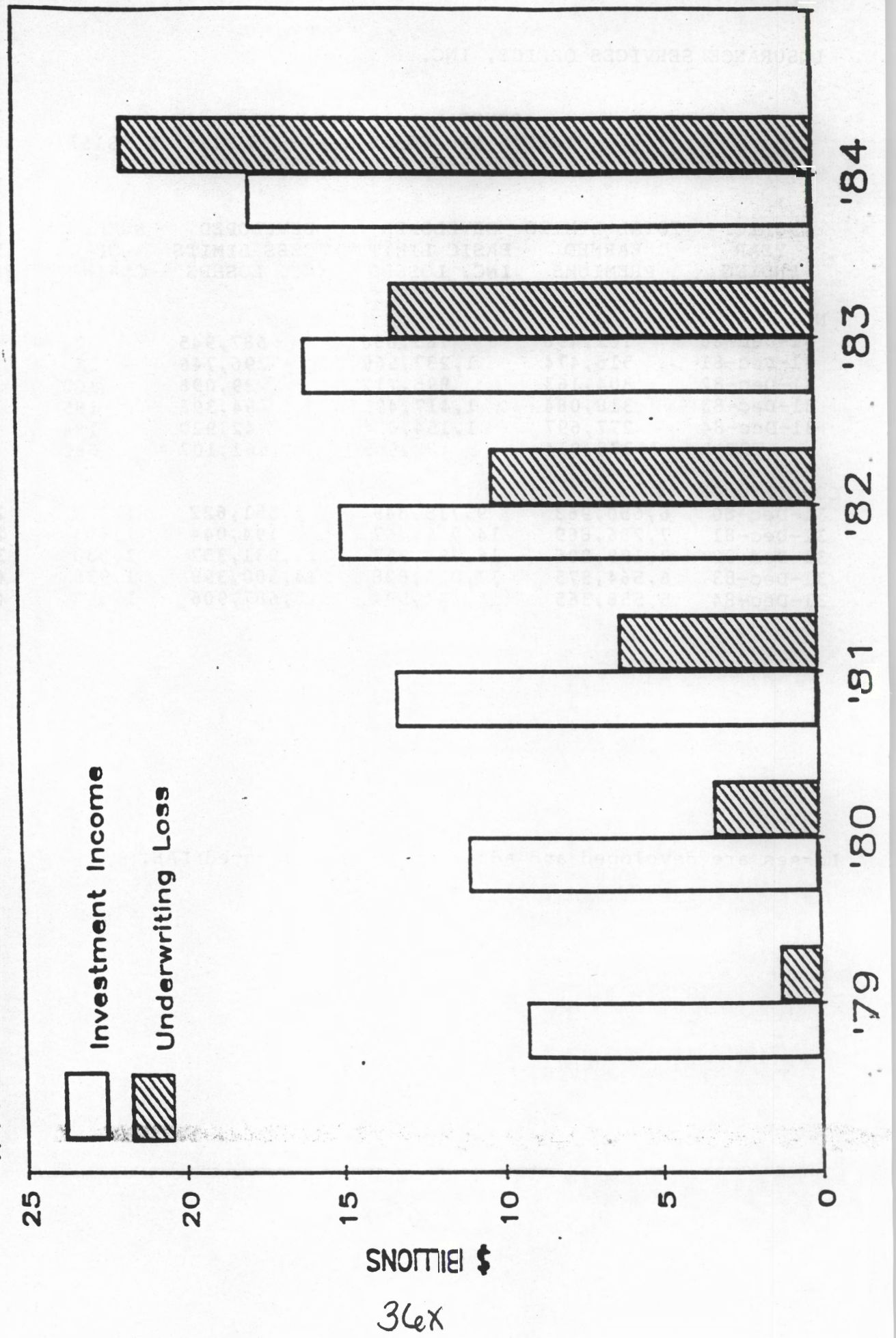
34x

GENERAL LIABILITY INSURANCE
STREETS AND ROADS (CLASSES 92151 & 93151)
MONOLINE AND PACKAGE BUSINESS

POLICY YEAR ENDING	TOTAL LIMITS EARNED PREMIUMS	DEVELOPED BASIC LIMIT INC. LOSSES	DEVELOPED EXCESS LIMITS INC. LOSSES	NUMBER OF CLAIMS	T/L LOSS RATIO
NEW JERSEY					
31-Dec-80	162,496	783,856	687,945	74	9.057
31-Dec-81	316,474	1,237,569	796,746	137	6.428
31-Dec-82	304,163	895,712	39,098	100	3.073
31-Dec-83	318,084	1,417,492	94,398	185	4.753
31-Dec-84	277,697	1,154,026	42,920	184	4.310
TOTAL	1,378,914	5,488,655	1,661,107	680	5.185
COUNTRYWIDE					
31-Dec-80	6,650,963	9,715,849	4,551,622	1,302	2.145
31-Dec-81	7,286,869	14,069,267	7,194,044	1,653	2.918
31-Dec-82	7,199,206	16,794,957	11,031,357	1,830	3.865
31-Dec-83	6,564,575	17,020,828	14,500,399	1,935	4.802
31-Dec-84	5,558,365	16,444,594	10,687,906	1,862	4.881

Losses are developed and adjusted for unallocated LAE.

35x


INVESTMENT INCOME VS. UNDERWRITING LOSS
Investment Income
Underwriting Loss
25
20
15
10
5
0
BILLIONS $
'79
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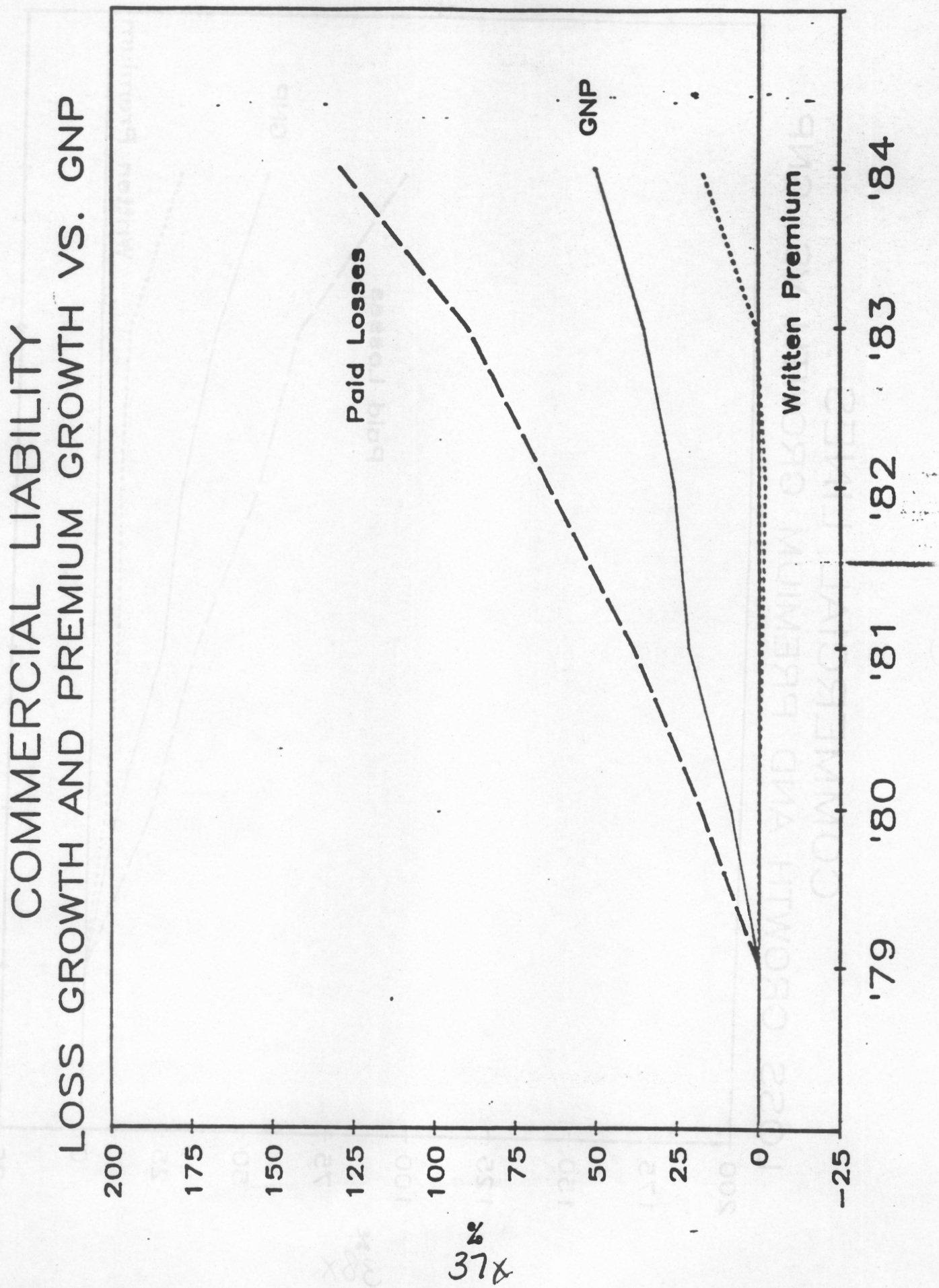
'81
'82
'83
'84

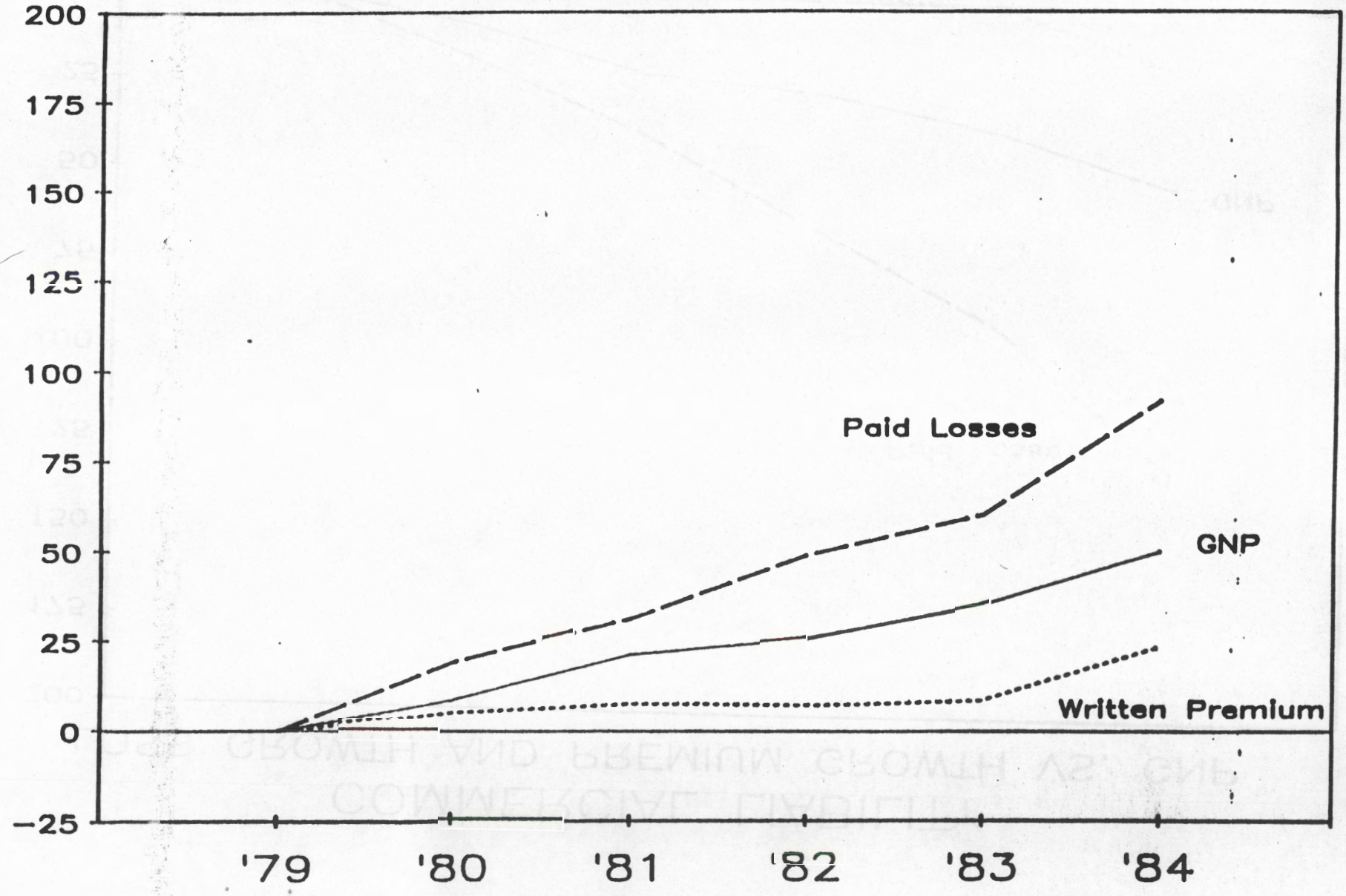
36x

B2-3

Chart B2-3



COMMERCIAL LINES
LOSS GROWTH AND PREMIUM GROWTH VS. GNP

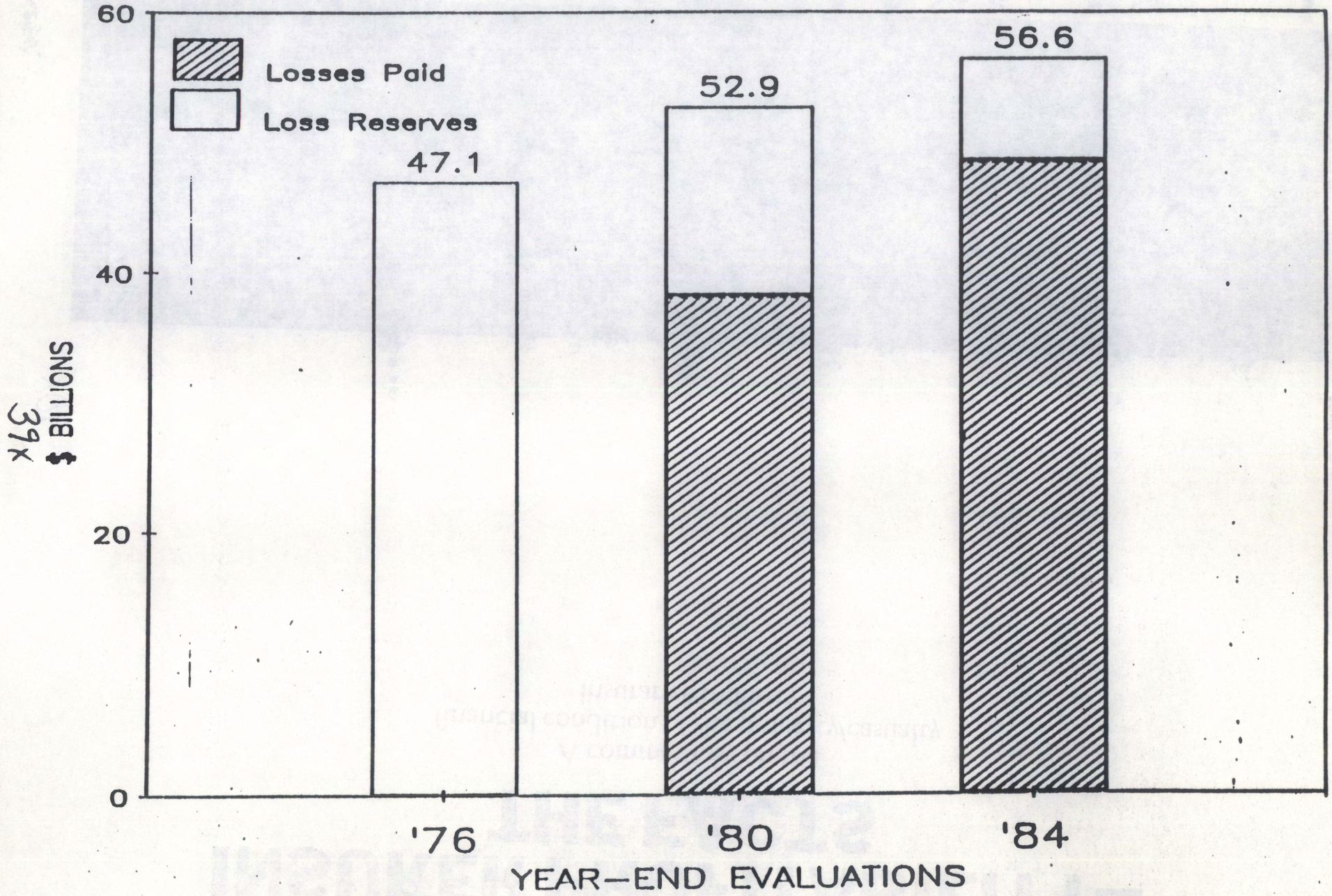


38%

Chart B2-2

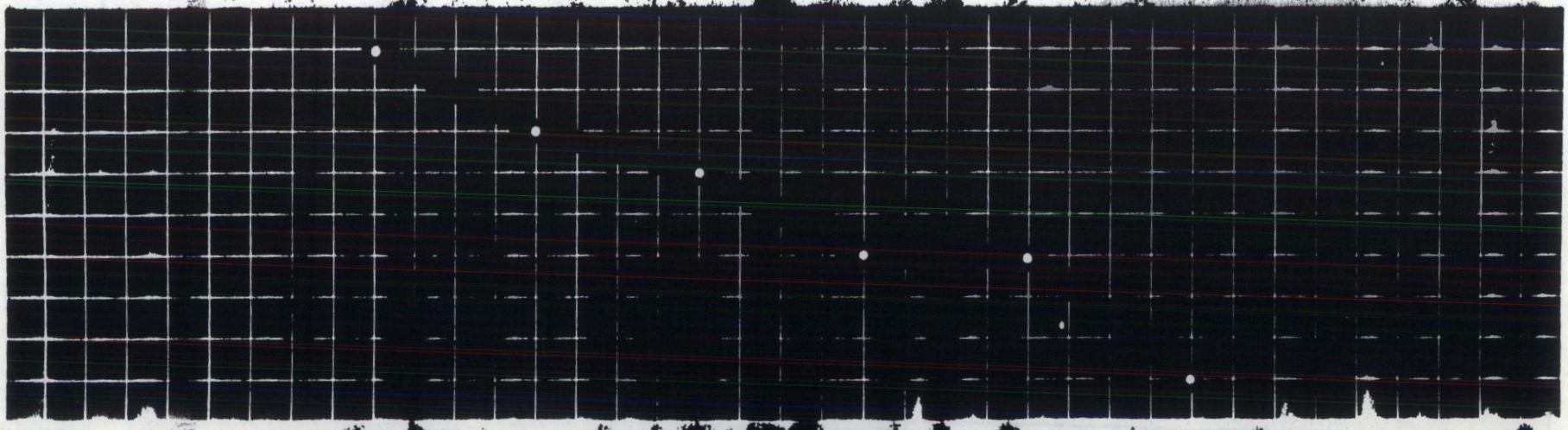
Chart B4-1

ALL LINES LOSS RESERVES — CALENDAR YEAR 1976



INSURER PROFITABILITY— THE FACTS

A commentary on the
financial condition of the property/casualty
insurance industry



Insurance Services Office, Inc.
February 1986

INSURER PROFITABILITY— THE FACTS

A commentary on the
financial condition of the property/casualty
insurance industry

X114

Insurance Services Office, Inc.
February 1986

PURPOSE

Given the current condition of the property/casualty insurance marketplace—with affordability and availability problems affecting many commercial insurance consumers—several critics have charged that the current large liability premium increases are unnecessary, that the industry's financial condition is improperly stated, and that its accounting procedures are misleading. In this analysis, Insurance Services Office, Inc. provides a fact-based review of the property/casualty insurance industry by (1) presenting a broad perspective of the industry's current financial condition, and (2) responding to factual errors and irrelevant data intended to substantiate the critics' charges, as well as providing a meaningful context for the numbers.

NOTE: Actual year-end 1985 results for the property/casualty insurance industry will not be compiled until late March 1986. Industrywide year-end figures cited by various analysts and critics in January 1986 were estimated results based largely on financial data through the first nine months. In this analysis, ISO references the financial statistics most often cited by critics—those estimates published by A.M. Best Company. This report is being issued prior to the release of year-end 1985 results in order to promptly provide comprehensive information.

The source of all historical financial data through 1984 is A.M. Best Company, with exceptions as noted. Nine-month 1985 financial data come from the A.M. Best Company or ISO compilations.

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- 1984 was the worst year to date for the property/casualty insurance industry./**12**
- Year-end 1985 results will show no significant improvement over 1984, despite substantial premium increases./**13**
- The companies that insure our nation's businesses have been particularly hard hit./**14**
- Reinsurers have experienced large financial losses./**14**
- Recent insurance industry financial results would have been worse without unprecedented realized capital gains and tax credits./**15**
- Premiums will have to increase faster than claim costs in order to achieve positive operating income in future years./**16**

MAJOR CHARGES RAISED BY INDUSTRY CRITICS/17

ACCUSATION: The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.

CHARGES
- The industry deliberately misstates loss reserves to produce a profitability "crisis," just as it did for medical malpractice 10 years ago./**19**
- Policyholder dividends are not a business expense, but a voluntary distribution of profits./**20**
- Insurers publicize operating income, rather than net after-tax income, in order to show losses./**21**
- The industry's return on net worth would have been 13% in 1984 if premiums had been only 5% higher. And the industry's rate of return for 1985 would be 13%, if you exclude policyholder dividends and unusually high hurricane losses./**23**

ACCUSATION: Price increases are excessive. Losses are not the problem.

CHARGES
- The industry needed to increase premiums only 12-15% in 1985 to achieve a 13-15% return in 1986. Given the estimated 20% premium increase in 1985, no additional price increases are needed in 1986./**25**
- Premium increases are so dramatic today solely because of prior inadequate prices. Losses are not the problem./**25**
- 1985's 71% increase in general liability premium was excessive. If insurers had not slashed liability rates a few years ago, they would have earned handsome profits./**28**
- Since, for medical malpractice, paid losses are less than investment income, this line can be treated on a "pay as you go" basis./**29**

ACCUSATION: Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.

CHARGES
- Property/casualty insurer stock prices rose by 50% in 1985, hardly indicative of a troubled industry./**31**
- The industry made $75 billion over the last 10 years and paid no taxes./**31**
- This is a typical cycle for the industry, and it will recover quickly./**33**

ACCUSATION: Insurance is too expensive.

CHARGES
- The total insurance bill in the U.S. rose to more than $300 billion in 1985./**38**
- Property/casualty premiums rose by $24.6 billion in 1985—an increase of $105 per person./**39**

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EXECUTIVE SUMMARY

A financially sound U.S. property/casualty insurance industry provides a vital service in the form of needed security to individuals and corporations. The cost of insurance affects almost every aspect of American life. Consequently, the economic integrity of this industry, as well as the availability and affordability of insurance, are critical to society.

In the past year, differences have emerged between the property/casualty insurance industry and its critics over the true financial condition of the industry and the need for large commercial liability premium increases. This has occurred despite the fact that quarterly and annual reports of the industry's financial results, as well as several special studies, have documented the weakened state of the industry and its current low profitability.

Critics have taken the industry's published financial information and distorted it to assert that, rather than being in financial peril, property/casualty insurers are actually engaged in price gouging and are hiding current profits. These charges are misleading, unsubstantiated and false.

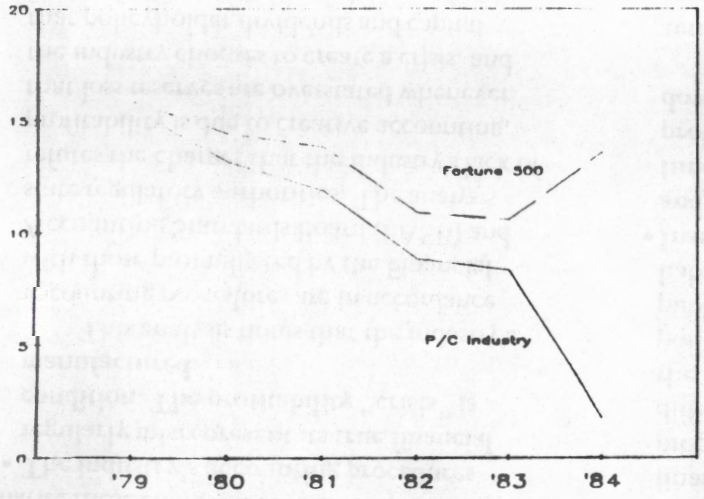
This analysis reviews the current financial state of the industry and refutes, on a point-by-point basis, the critics' charges.

All facts point to the inevitable conclusion that 1984 was the worst year to date for the property/casualty insurance industry. The weakened condition of the industry is highlighted by:

- a return on net worth of less than 2% and an operating loss of nearly $4 billion, both record low levels;
- a record number of insurer insolvencies;
- a record number of insurers placed on a "watch list," based on tests of financial strength developed by the National Association of Insurance Commissioners; and
- a wholesale downgrading of insurer ratings by A.M. Best Company.

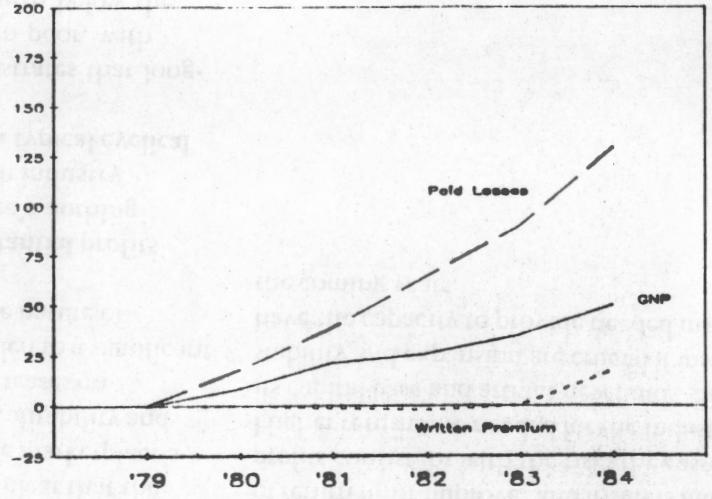
During the 1980's, the return on net worth for the property/casualty industry moved increasingly below the average rate for the Fortune 500 companies. **(See chart A.)** And results for the first nine months of 1985 indicate no major improvement in profitability. The annualized return on net worth was 4%, and operating losses as of nine months were at record levels. Rather than producing large profits for insurers, the 1985 premium increases have slowed the dramatic downslide and possibly signalled the beginning of the long road back to adequate levels of profitability. The number of insurer insolvencies in 1985 has already matched the all-time record, set in 1975, with the books for 1985 insolvencies not yet closed.

Critics have made charges about the industry's financial condition that fall under four



A

Return on Net Worth: Property/ Casualty Industry vs. The Fortune 500 (%)



B

Loss Growth and Premium Growth vs. GNP (%): Commercial Liability

broad accusations. The following paragraphs summarize these charges and ISO's responses.

- **The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.**

  This analysis notes that the industry's accounting procedures are in accordance with those promulgated by the Financial Accounting Standards Board (FASB) and state regulatory authorities. The analysis refutes the charges that the industry's lack of profitability is due to creative accounting, that loss reserves are overstated whenever the industry chooses to create a crisis, and that policyholder dividends and capital gains are improperly treated.

- **Price increases are excessive. Losses are not the problem.**

  This analysis shows that the recent, substantial commercial liability price increases are necessary. The explosive growth in claim payments, in combination with depressed premiums, continues to create an urgent need for large premium increases in the commercial lines. These premium increases will not recoup lost profits; rather, they have begun the process of bringing current premiums in line with current losses. Losses *are* a serious problem, since loss growth substantially outpaced growth in GNP. **(See chart B.)**

  The underlying causes of loss growth are not discussed in detail in this strictly financial analysis. But it is clear that the property/casualty insurance marketplace's difficulties—low insurer profitability and the impact of premium increases on policyholders—have now led to a significant public debate regarding the nature of liability in our society.

- **Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.**

  This analysis demonstrates that long-term profitability has been poor, with insurers' return on net worth below the average of the Fortune 500 companies in eight of the last 10 years. The last two years have been particularly poor, even for a low point in the cycle. This is not a typical cycle. It is both longer in duration and deeper in magnitude than any previous cycle in the property/casualty insurance industry's history. With regard to taxes, the analysis indicates that the industry is in compliance with federal law.

- **Insurance is too expensive.**

  This charge is both misleading and emotionally charged. First, the critics include life, accident and health insurance premiums with those for property/casualty insurance, thereby increasing the figures in their charges. Second, losses have increased dramatically, and the premiums to pay for them must rise as well.

Conclusion

The property/casualty insurance industry's rate of return must improve, and insurers must achieve profits consistent with the risks they assume. Higher returns are needed for the industry to retain its capital base and attract new funds. Such stability and expansion are crucial if insurers are to have the capacity to provide needed insurance in the coming years.

OVERVIEW OF THE FINANCIAL CONDITION OF THE PROPERTY/CASUALTY INSURANCE INDUSTRY

In the past year, differences have emerged between the property/casualty insurance industry and its critics over the true financial condition of the industry. The insurance industry claims that it is experiencing unprecedented losses, while its critics claim that the industry is really profitable. This section will provide the facts.

A critical measure of financial results is the return on net worth, which is commonly used by investors for inter-industry performance comparisons. Responsible analysis of any industry must also look beyond that measure and evaluate the components of economic income. How does the property/casualty industry make its money? What impact do state and federal regulations have on insurance accounting procedures? What are the components of net income after taxes? Which of those components are inextricably tied to the underwriting operations of insurers? Which are subject to fortuitous events?

This section examines the elements that are critical to any analysis of insurer profitability. The following conclusions emerge:

- 1984 was the worst year to date for the property/casualty insurance industry.
- Year-end 1985 results will show no significant improvement over 1984, despite substantial premium increases.
- The companies that insure our nation's businesses have been particularly hard hit.
- Reinsurers have experienced large financial losses.
- Recent insurance industry financial results would have been worse without unprecedented realized capital gains and tax credits.
- Premiums will have to increase faster than claim costs in order to achieve positive operating income in future years.

The key support for each of these conclusions is as follows:

1984 was the worst year to date for the property/casualty insurance industry.

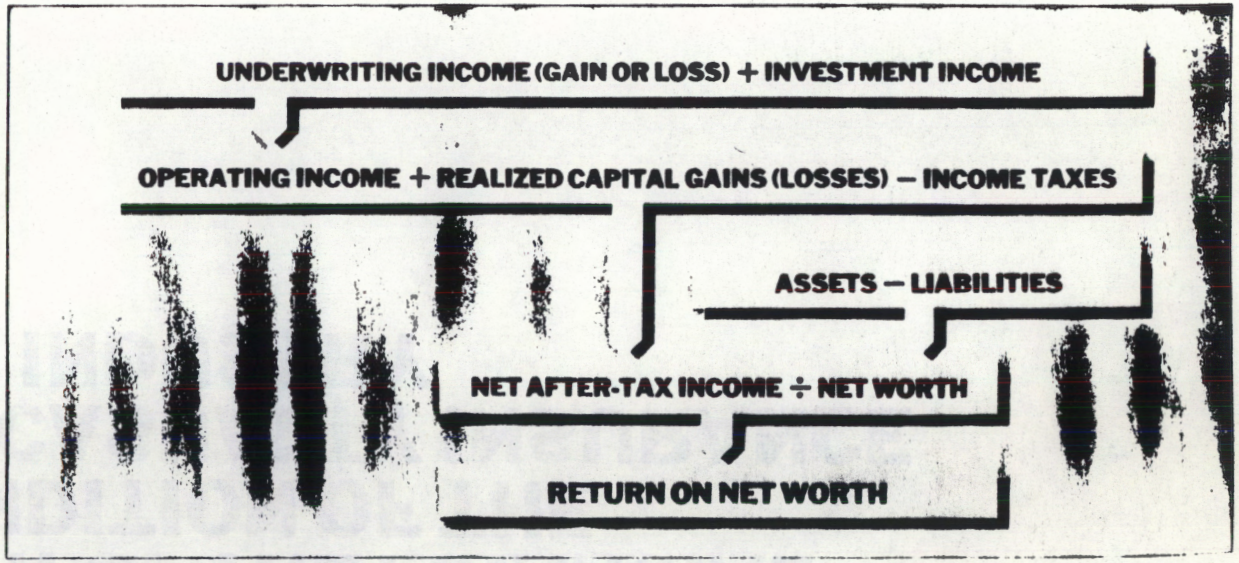
The industrywide *return on net worth*[1] was below 2% in 1984, with total earnings of $1.3 billion. The Fortune 500 companies' median return was 13.6% in 1984, averaged 13.2% over the last ten years, and has never fallen below 10% over that span. During the 1980's, the return on net worth for the property/casualty industry has moved increasingly below the average rate for the Fortune 500. **(See chart 1.)**

Some insurers reported returns higher than the industry average in 1984, while others had

[1] *Return on net worth is net income after taxes divided by total net worth. In this report, both income and net worth figures have been calculated to be consistent with generally accepted accounting principles (GAAP) as set forth by the Financial Accounting Standards Board (FASB). GAAP-adjusted figures for both income and net worth are larger than corresponding statutory figures, which are based on more conservative measurements. For example, in 1984, statutory surplus was $64 billion compared with GAAP-adjusted net worth of $75 billion; statutory net income was $0.8 billion compared with GAAP-adjusted net income of $1.3 billion.*

THE MAJOR COMPONENTS OF INSURER PROFITABILITY

Operating income comprises underwriting income and investment income. It is a component of net after-tax income. The other major components are realized capital gains (losses) and income taxes. An insurer's net worth consists of assets minus liabilities.



lower earnings. Many companies actually lost money overall. In fact, 330 of the nation's 867 insurer groups, representing 40% of industry premiums, recorded negative returns. Eighty-four insurers lost more than one-quarter of their surplus during 1984.

The most important component of insurers' net income after taxes is operating income—the sum of underwriting income and investment income. It represents profit or loss from insurance operations. Other components of net income after taxes include realized capital gains and federal income taxes. The diagram on page 12 illustrates the relationships among the major components of insurer profitability.

Underwriting income (the difference between premiums earned and the sum of losses on claims, expenses and policyholder dividends) has actually been underwriting *loss* beginning in 1979. Each subsequent year brought ever-growing underwriting losses—reaching a staggering $21.5 billion in 1984.

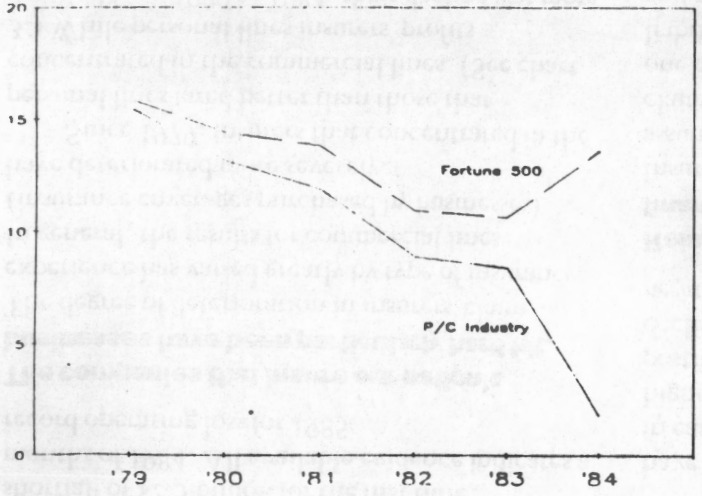
In all but two years of its history, the industry's *investment income* (the interest and dividends received on investments) was enough to offset underwriting losses. **(See chart 2.)** The first time investment income did not exceed underwriting losses was in 1975, when investment income fell short of the underwriting deficit by $300 million. In 1984, a new record was set, with underwriting losses exceeding investment income by $3.8 billion. Only unusually large realized capital gains and tax credits allowed the industry's bottom-line earnings to be positive in 1984.

Year-end 1985 results will show no significant improvement over 1984, despite substantial premium increases.
Figures for the first nine months of 1985 showed slight improvement over the comparable period in 1984, but the annualized 4% return on net worth was still far from acceptable by any business standard. It is unlikely that the full-year 1985 returns on net worth will exceed 4%.

The underwriting loss for 1985 will exceed the 1984 record of $21.5 billion. During the first nine months of 1985 the industry recorded an underwriting loss of $17.8 billion, compared with a loss of $15.2 billion for the first nine months of 1984.

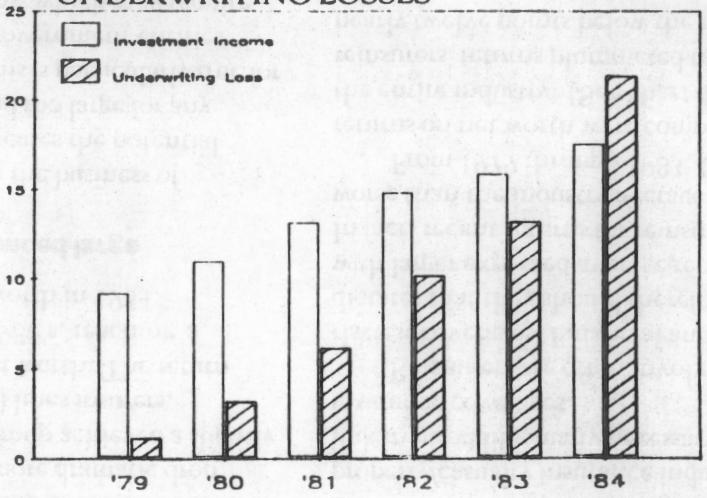
During the first nine months of 1985, investment income fell short of the underwriting loss by $3.5 billion, compared with a

1 PROPERTY/CASUALTY RETURNS HAVE PLUMMETED



Return on Net Worth: Property/ Casualty Industry vs. The Fortune 500 (%) *Returns on net worth for the property/casualty industry have consistently lagged behind those for the Fortune 500 companies, plummeting 12 points below the Fortune 500 in 1984.*

2 INVESTMENT INCOME NO LONGER OFFSETS UNDERWRITING LOSSES



Investment Income vs. Underwriting Loss ($ Billions) *Investment income offset underwriting losses in every year from 1979 to 1983. In 1984, investment income fell short—creating a $4 billion operating loss. This operating loss will continue at least through 1985.*

shortfall of $2.5 billion for the first nine months of 1984. All available evidence indicates a record operating loss for 1985.

The companies that insure our nation's businesses have been particularly hard hit. The degree of deterioration in insurers' claim experience has varied greatly by type of insurance. In general, the results for commercial lines (insurance coverages purchased by businesses) have deteriorated more severely.

Since 1979, insurers that concentrated in the personal lines fared better than those that concentrated in the commercial lines. (See chart 3.) While personal lines insurers' profits dropped from 1979 to 1984, their decline was more moderate. The return on net worth for predominantly personal lines insurers fell from over 13% in 1979 to below 8% in 1984.

Insurers that concentrate in commercial lines have experienced a much more dramatic drop in earnings. In 1979, this group achieved a slightly higher return than personal lines insurers, posting a 15% return on net worth. The return declined during the early 1980's, reaching a *negative* 3% return on net worth in 1984.

Reinsurers have experienced large financial losses. Insurance companies are in the business of assuming risk, but in many cases the potential claims are too uncertain and too large for any one company to absorb. This is particularly true for liability policies covering government entities and many large corporations, which may require coverage limits of $50 million or more. In response to these expanding liability coverage needs, reinsurers[2] (often described as companies that insure insurance companies) have grown to be an important segment of the property/casualty insurance industry and a crucial link in providing many necessary types of insurance coverages.

Reinsurers are often involved in the riskiest coverages. Financial and economic theory dictates that they should therefore be rewarded with larger expected average returns on net worth. In fact, recent returns for reinsurers have been worse than the industry average.

From 1979 through 1983, U.S. reinsurers' returns on net worth were comparable to those of the entire industry. (See chart 4.) In 1984, reinsurers' returns plummeted to a *negative* 10%, nearly twelve points below the industry

[2]*For a more thorough discussion of reinsurance, see the Appendix.*

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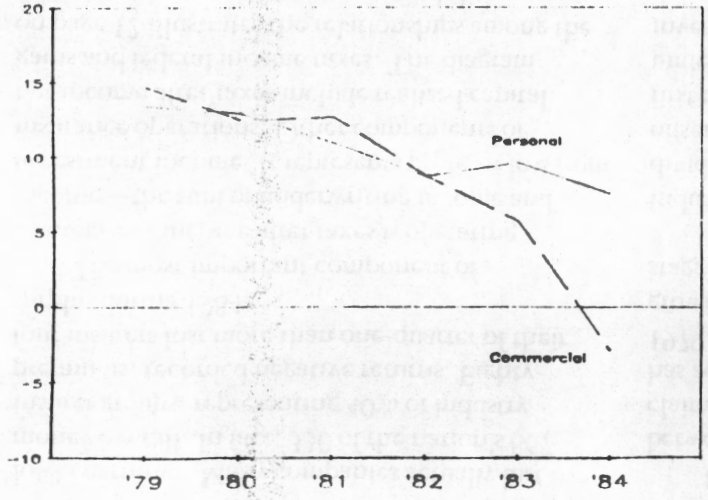
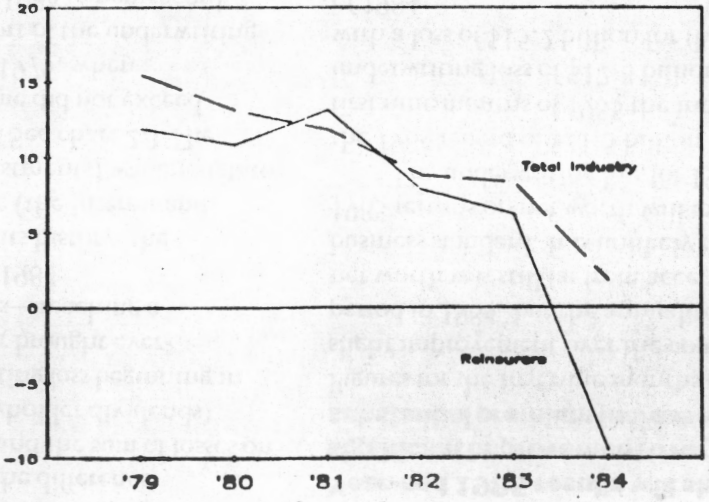
3 COMMERCIAL INSURERS LOST MONEY IN 1984



Return on Net Worth: Personal vs. Commercial Insurers (%) *Commercial lines insurers have experienced a dramatic decline in their returns on net worth over the last four years, dropping to negative 3% in 1984. Personal lines insurers' returns also declined, but less precipitously.*

4 REINSURERS LOST MONEY IN 1984



Return on Net Worth: Reinsurers vs. Total Property/Casualty Industry (%) *U.S. reinsurers lost money in 1984 — a factor in 1985's commercial lines marketplace.*

average. This result was a significant factor in the insurance marketplace disruptions that occurred in 1985. Many reinsurers withdrew partially or totally from writing business; others restructured coverages (adding exclusions or restrictions) and increased prices in an attempt to return to profitability.

Recent insurance industry financial results would have been worse without unprecedented realized capital gains and tax credits.

The major components of net income after taxes are operating income (the sum of underwriting income and investment income), realized capital gains and federal income taxes. Although the industry produced an operating loss of $3.8 billion in 1984, this loss was offset by other sources of income. These other sources of income are not predictable or regularly recurring and therefore cannot be depended on to provide similar amounts of additional income in future years.

A major source of non-repeatable income for many insurers during the last three years was *realized capital gains*. These gains occur when insurers sell assets that have risen in value since they were purchased. Until very recently, capital gains realized by the property/casualty industry were relatively insignificant compared to net worth. (See chart 5.) From 1975 to 1982, total realized capital gains never exceeded 1% of net worth. In 1983, the ratio grew to 3% and continued upward in 1984 to 4%.

Capital gains may be realized under two sets of circumstances. If the overall stock market performance is relatively flat, offering little if any appreciation in value for shareholders, large investors with a portfolio of both winners and losers may be able to sell the winners—stocks that increased in value since the time of purchase. These investors will have realized a capital gain. But by keeping the losers, they have incurred an offsetting *unrealized* capital loss, since their portfolio account now consists of stocks with depreciated value. These circumstances generally prevailed in 1984.

Under a second set of circumstances, exemplified by 1985, the stock market rises dramatically. Under those circumstances, investors may be able to realize extraordinary capital gains. But if the existing securities are sold and new ones are purchased, only additional substantial market appreciation will produce

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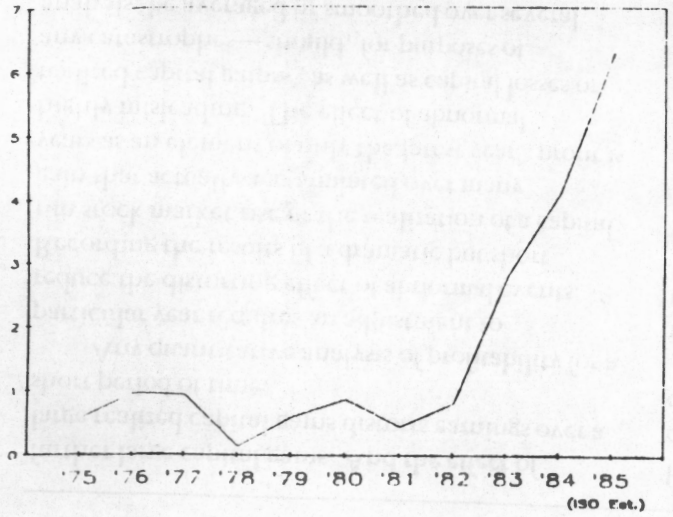
5 REALIZED CAPITAL GAINS AT RECORD LEVELS



Realized Capital Gains (% of Net Worth) *Realized capital gains grew to unprecedented levels in 1984 and 1985.*

further large capital gains. And the effect of large realized capital gains distorts earnings over a short period of time.

Any quantitative analysis of profitability for a particular year requires an adjustment to reduce the distorting effect of abnormal events. Recording the results of a dramatic but short run stock market rise or the realization of a capital gain that actually accumulated over many years as an element of only the latest year's profit is highly misleading. The effect of abnormal realized capital gains—as well as capital losses or any catastrophes—should, for purposes of analysis, be averaged or smoothed over several years. Certainly, in assessing future years' rates of return, only a "normal" amount of realized capital gains should be assumed.

A second major source of non-repeatable income for insurers in the last few years is tax credits. Tax credits are available to those businesses that have incurred a pre-tax net loss for a given tax year and paid taxes during a prior profitable period. Tax credits may also be used by a company that is a subsidiary of an otherwise profitable parent. During the last two years, nearly $4 billion in tax credits have been utilized by the property/casualty industry. Clearly, tax credits at these levels cannot be expected to continue.

In summary, the property/casualty insurance industry benefited from nearly $5 billion of realized capital gains and tax credits in 1984. Without those extraordinary items, the industry would have incurred a large overall net loss. Over the prior twenty years, the average of total capital gains and federal income taxes was a net of only $500 million a year. Given their historically small contribution to total profit, realized capital gains and tax credits cannot be relied upon to provide a continuing and consistent bailout for operating losses. If the industry is to maintain a reasonable level of profitability for the long term, profits must come from operating income.

Premiums will have to increase faster than claim costs in order to achieve positive operating income in future years.

Positive operating income—the difference between underwriting loss (after policyholder dividends) and investment income—has been hard to achieve. Although investment income has grown steadily over the last decade to nearly $18 billion in 1984, its average annual increase since 1980 has been less than $2 billion, while underwriting losses increased at an average annual rate of over $4 billion. All available evidence indicates a record operating loss for 1985, despite substantial premium increases. If operating income is to become a source of profits, underwriting losses must be drastically reduced from the 1984 level of more than $21 billion. For this to happen, premium increases would have to continue to exceed the rate of growth in claim costs.

MAJOR CHARGES RAISED BY INDUSTRY CRITICS

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The property/casualty insurance industry has recently been a target of criticism. Critics charge that, by manufacturing a crisis, insurers hope to lobby legislators to implement tort reform. A notion common to many of these criticisms is that the "actual" results reported by insurance companies are not actual at all, because they are based on *estimates* of loss reserves that insurers set aside to cover future loss payments. Some critics argue that the industry inflates the amount of money it reserves when it wants to show that it is unprofitable and puts less money in reserves when it chooses to show a profit. History does not support these charges. Financial analysts of the business have noted that, in times of low profitability, many insurers set aside less than they should to cover future losses on current or past policies.

The following pages contain 13 specific charges, together with the relevant facts that refute these charges, organized under four major accusations:

- The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.
- Price increases are excessive. Losses are not the problem.
- Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.
- Insurance is too expensive.

56X

ACCUSATION

The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.

CHARGE: The industry manipulates its financial results by deliberately misstating reserves held to make future loss payments. Industrywide estimates of future loss payments are often overstated, thus producing a "crisis." During the last "crisis," the industry seriously overreserved, particularly in medical malpractice. It has again manufactured this current "crisis" in availability and affordability by overstating reserves.

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THE FACTS: These charges have no basis in fact and contradict the consensus opinion of acknowledged financial analysts, who believe that current loss reserves are understated. A published ISO study concluded that year-end 1982 industrywide loss reserves were deficient by more than 10%. Subsequent ISO analyses indicate that no significant strengthening occurred in industry loss reserves through year-end 1984. Furthermore, experience has shown that industry loss reserves were seriously *understated* at the time of the last "crisis" in 1976.

It is true that loss reserves are estimates, made by insurers on a given date, of liabilities for additional loss payments that will ultimately be made for a particular set of claims. State insurance commissioners, charged with overseeing the solvency of insurers, suggest that these liabilities be reported at their full ultimate value for most lines of insurance. Reserves are particularly significant for the liability lines, for which the final payout may not be known for many years, which is why such lines are known as "long-tail" lines.

At the time of the last "crisis"—1976—the reserves set aside at year-end 1976, for all claims incurred to that date, were $47.1 billion. As of year-end 1984, $48.6 billion had been paid out on those initial pre-1977 claim reserves. And an additional $8.0 billion was still held in reserve for the same group of claims—for a total payment of $56.6 billion rather than the $47.1 billion originally expected. The nearly $10 billion difference represents an initial reserve deficiency of 20%. **(See chart 6.)**

One reason that reserves set in the past for long-tail lines such as general liability have proven to be deficient is that scientific, technological and societal changes have revealed new sources of exposure to injury and new theories of legal liability. For example, when general liability loss reserves were established 10 to 20 or more years ago, insurers could not have predicted the huge number of claims related to asbestos, Agent Orange, DES, and other alleged causes of latent injuries under policies already written. At that time, no reserves were set up for future payments of those losses. It is now clear

that the initial general liability reserves will prove to be significantly understated.

This pattern of underreserving can easily be seen in two particularly long-tailed lines, general liability and medical malpractice. In 1976, general liability claim payments already made, plus the reserves carried for future payments on policies written through that year, totaled $24.0 billion. At year-end 1984, the estimated costs for those same general liability claims had risen to $28.0 billion, of which $26.0 billion had already been paid. (See chart 7.) This means that, as of year-end 1984, the original 1976 general liability reserve was already *insufficient* by $4 billion.

For medical malpractice, the estimate for ultimate claim payments on the policies written through 1976 initially totaled $1.9 billion. The year-end 1984 estimate for those same medical malpractice losses had risen to $2.3 billion, of which $1.9 billion had already been paid. (See chart 8.) This means that, as of year-end 1984, the original 1976 medical malpractice reserve was already *insufficient* by $400 million.

The 1976 loss reserves were not unique. More recent years show a similar pattern of final losses that are likely to exceed the initial reserves. For example, the 1979 reserve for liability lines was $65.3 billion at year-end 1979. As of year-end 1984, $53.8 billion of those reserves had been paid and $15.7 billion was still held in reserve, for a total of $69.5 billion—an initial reserve *deficiency* of more than $4 billion (6%) as of year-end 1984. (See chart 9.) Given recent historical trends, it is likely that estimated final claim payments—and, therefore, the reserve deficiencies—will grow as later evaluations are made.

CHARGE: Policyholder dividends should not be included with losses in determining underwriting results. Policyholder dividends are not a business expense, but a voluntary choice of profitable companies to distribute some of the profit to policyholders.

THE FACTS: Policyholder dividends, although not "losses", are price discounts to customers that are legitimate business expenses, deductible from income. This treatment follows that dictated by statutory accounting procedures developed by the National Association of Insurance

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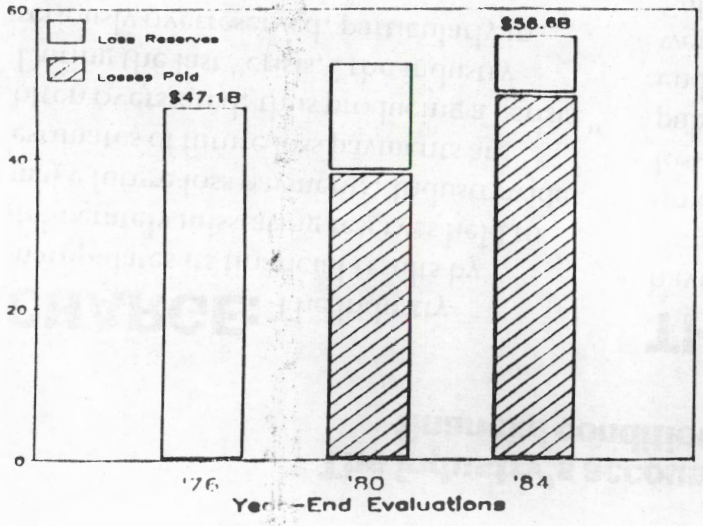
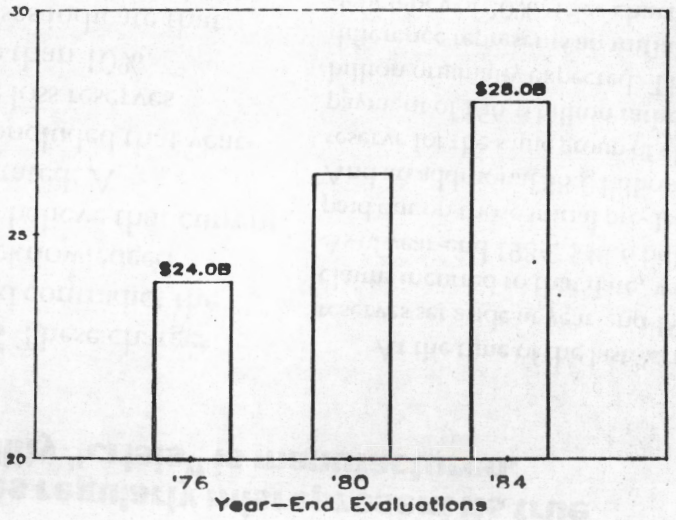
6 1976 INDUSTRY RESERVES FELL SHORT



Calendar Year 1976 Loss Reserves ($ Billions) *The reserves set aside at year-end 1976 proved to be nearly $10 billion (20%) short eight years later.*

7 1976 GENERAL LIABILITY RESERVES FELL SHORT



General Liability Incurred Loss Development—1976 ($ Billions) *Estimated costs of general liability claims incurred through 1976 proved to be $4 billion too low by year-end 1984.*

Commissioners and is consistent with generally accepted accounting principles as articulated by the Financial Accounting Standards Board (FASB). The opinion of the independent accounting firm of Coopers & Lybrand supporting this treatment may be found in the Appendix.

The charge that policyholder dividends should not be treated as expenses could just as easily—and just as mistakenly—be applied to any price discount a company offers its customers to encourage the purchase of the company's product or service. And that's what policyholder dividends are: a price discount. When manufacturers offer a $10 refund on the price of a coffeemaker or a $500 rebate on the price of a car, they are not distributing profits; rather, they are incurring an expense that is, in effect, a price cut. As with manufacturers offering price discounts, policyholder dividends are appropriately recognized as an insurer expense that *reduces* profits. Policyholder dividends are not a distribution of profits.

Policyholder dividends are unlike dividends to stockholders. Policyholder dividends represent a portion of gross revenues that a company has designated for return to its policyholders. Many insurer managements pay dividends to policyholders as a competitive tool to retain business. Also, many insurers grant dividends to policyholders whether they are profitable or not, treating the practice as a necessary cost of doing business. (See chart 10.)

On the other hand, dividends to stockholders of *any* business corporation represent a distribution to its owners of a portion of current or past earnings, based on each owner's total holdings. Unlike policyholder dividends, stockholder dividends do not offset income. They are charged directly to net worth.

CHARGE: The property/casualty insurance industry defines "income" to exclude certain items, such as realized capital gains. Insurers report operating income, rather than net after-tax income, to show they had losses when they really made money.

THE FACTS: This charge is false. Every quarter, statistics compiled and released by ISO highlight net after-tax

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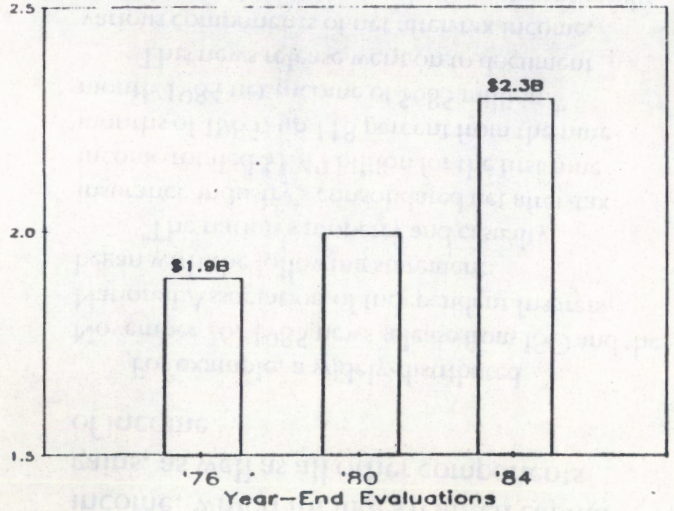
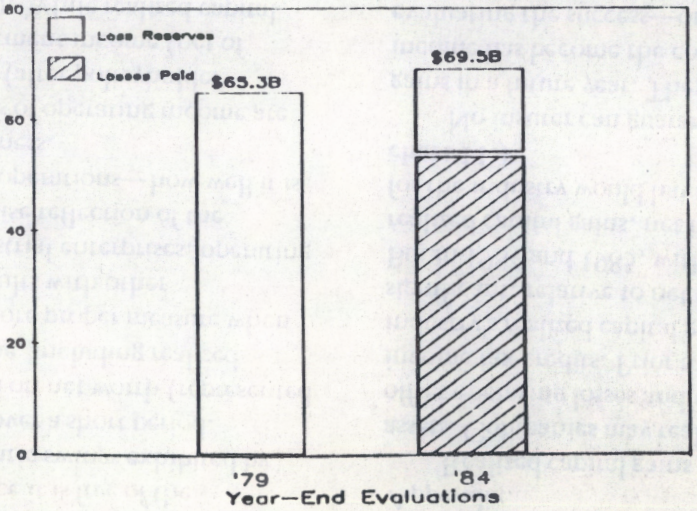
8 1976 MEDICAL MALPRACTICE RESERVES FELL SHORT



Medical Malpractice Incurred Loss Development—1976 ($ Billions)
Estimated costs of medical malpractice claims incurred through 1976 proved to be $400 million too low by year-end 1984.

9 1979 INDUSTRY RESERVES FELL SHORT



Calendar Year 1979 Liability Loss Reserves ($ Billions)
The reserves set aside at year-end 1979 for liability lines were more than $4 billion (6%) deficient just five years later.

income, which includes realized capital gains, as well as all other components of income.

For example, a widely-distributed November 26, 1985 news release from ISO and the National Association of Independent Insurers began with the following statement:

"The nation's property and casualty insurance industry's consolidated net after-tax income totaled $1.49 billion for the first nine months of 1985, up 118 percent from the nine-month 1984 net income of $685 million."

This news release went on to document various components of net after-tax income, including underwriting results, investment results and pre-tax operating income—all important and commonly-used measures of an insurer's business.

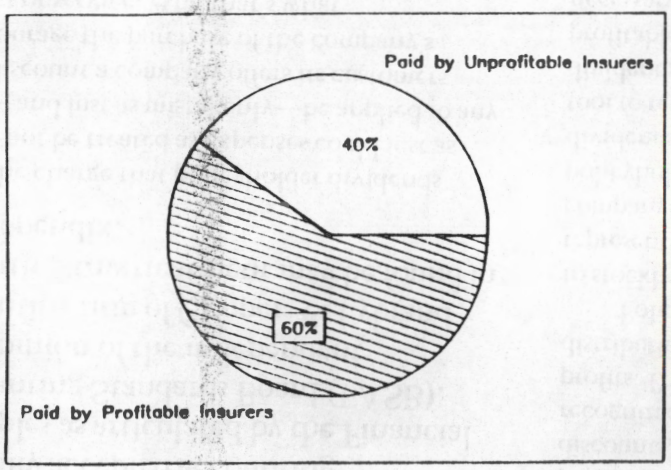
Pre-tax operating income is important to financial analysts, since it is free of the unpredictable and erratic swings exhibited by realized capital gains over a short period. While the total return on net worth (represented by net after-tax income, including realized capital gains) is the more proper measure when comparing insurer results with other commercial and industrial enterprises, operating income is a more precise reflection of the company's insurance operations—how well it is doing in its basic business.

The components of operating income are underwriting income (after policyholder dividends) and investment income (net of investment expenses). While realized capital gains are considered in the determination of taxable income, they are not part of operating income. The opinion of the independent accounting firm of Coopers & Lybrand supporting this treatment may be found in the Appendix.

Realized capital gains reflect a decision to sell assets. Companies may realize capital gains to offset operating losses and/or to utilize federal income tax credits. Prior to 1983, the industry's realized capital gains were not significant, relative to net income after taxes. But in 1984 and 1985, without unprecedented realized capital gains, net income after taxes for the industry would have been a net *loss*. (See **chart 11.**)

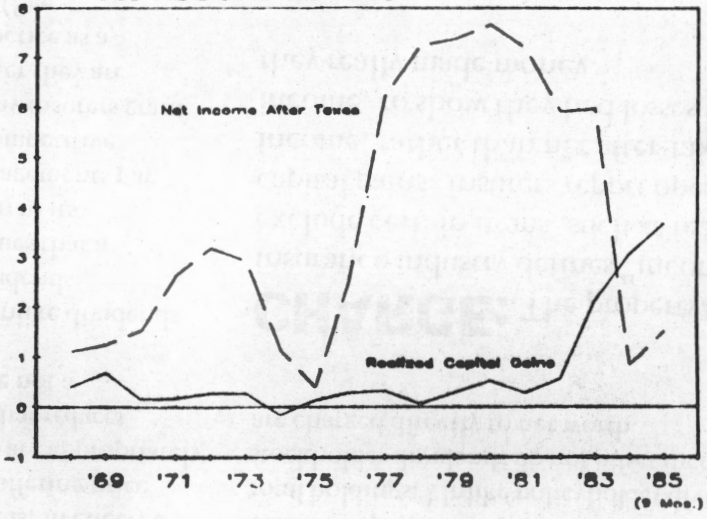
No insurer can guarantee large realized capital gains in a future year. Therefore, operating income has become the common measure for evaluating the success—or lack thereof—of an insurance company's operation.

10 WHO PAID POLICYHOLDER DIVIDENDS IN 1984?



Insurers with a negative return on net worth paid 40% of 1984 policyholder dividends.

11 INSURERS REALIZED CAPITAL GAINS AT RECORD LEVELS



Realized Capital Gains and Net Income After Taxes ($ Billions) *Only the unprecedented levels of gains from the sale of assets allowed the industry to show positive net income after taxes in 1984 and 1985.*

CHARGE: In 1984, property/casualty insurers earned about a 3% rate of return on net worth. That is too low. However, if their premium had been 5% higher, they would have earned a rate of return on net worth of about 13%. In 1985, insurers' return on net worth rose to an estimated 7%. If the effects of dividends to policyholders and unusually high hurricane losses in 1985 were removed, the industry's return on net worth in 1985 would have been about 13%, the average for all American industries.

THE FACTS: The 3% return on net worth quoted by critics for 1984 is wrong. More importantly, the conclusion that an additional 5% of premium would add 10 points to that return is also wrong. Similarly, the estimated 7% return on net worth for 1985 is too high. More importantly, the adjustment to the 1985 return, adding 6 points to the estimated value, is inaccurate, inappropriate and misleading.

First, the 3% rate of return quoted by critics for 1984 is wrong. The actual figure is 1.7%. Second, an additional 5% of premium would have added about 6 points to the return on net worth. This 6-point increment is based on the conservative assumption that fixed expenses will not grow at all despite the increased revenues. If one assumes growth in fixed expenses, the additional return is 5 points.

With regard to 1985, although the critics' adjustments are unsupported, it appears that policyholder dividends have been added back into income (incorrectly raising the return by 3 points) and *all* catastrophe losses have been removed (incorrectly adding another 3 points to the return). The proper adjustments to calculate a hypothetical industry rate of return—for a year with normal events—include removing the effect of all unusual events—not only unusual catastrophe *losses*, but unusual realized capital *gains* as well. These adjustments would lower the 1985 return on net worth by about 3 points—not raise it by 6 points.

Dividends to policyholders are premium discounts to customers, rather than a distribution of profits to owners. They are properly considered as a legitimate business expense in the determination of the rate of return on net worth. Removing the effects of policyholder dividends on income is inaccurate. (See page 20.)

Catastrophe losses are defined as events that cause more than $5 million of insured losses. 1985 was indeed a year of unusually high catastrophe losses, totaling $2.8 billion or about 2.1% of premium. The average annual catastrophe loss over the last 10 years has been 1.3% of premium. **(See chart 12.)** To calculate the return on net worth as if 1985 had been a more typical year, an average annual catastrophe loss amount should be substituted for 1985's actual catastrophe losses. Using 1.3% rather than 2.1% to smooth the dollar value of catastrophe losses would raise the return on net worth by approximately 1 point.

But to restate the 1985 return as a more typical year, one should also adjust the component of 1985 insurer profitability that showed the most atypical result—realized capital gains. The average annual realized capital gain over the last 10 years has been 0.51% of assets, while 1985 realized capital gains are estimated to be $5.3

billion or 1.75% of assets—more than three times the 10-year average. (See chart 13.) Substituting the average capital gains for the 1985 amount reduces the return on net worth by 4 points.

Using a long-term average for both catastrophe losses and realized capital gains lowers the return on net worth by approximately 3 points.

Not only do the critics err in how they apply adjustments, but their estimate of a 7% return on net worth for 1985 is too high. This estimate appears to include both unrealized capital gains, as well as an incorrect amount for federal income tax credits as income. Unrealized capital gains are not income and should not be included as such in a calculation of the 1985 return on net worth. The latest estimate of 1985 federal income tax credits is $1.9 billion, rather than the $3.5 billion that appears to be included in the estimate of 7%. Correcting both of these errors would lower the return by several additional points.

These errors have been partially recognized by critics who, more recently, quoted a revised return on net worth of 6% for 1985—still an overestimate.

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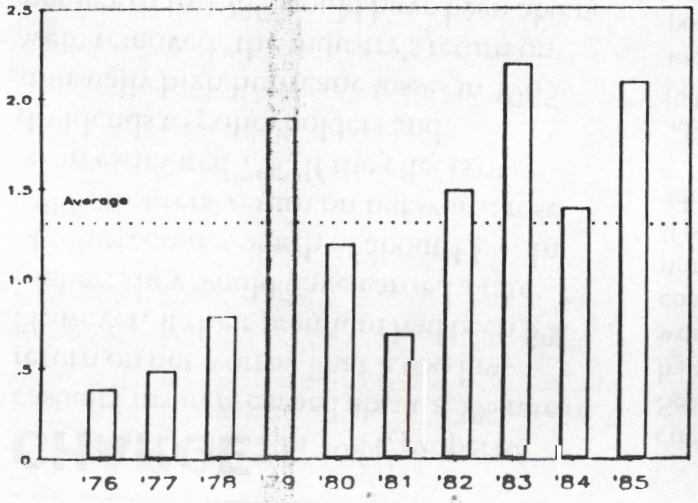
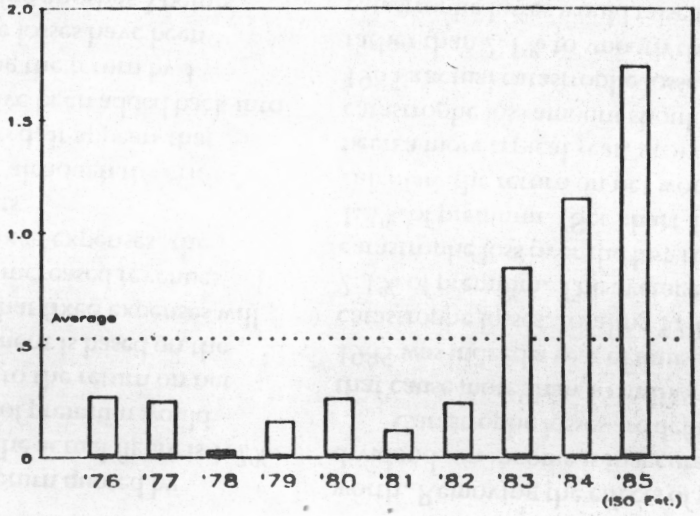
12 CATASTROPHE LOSSES CANNOT BE IGNORED



Catastrophe Losses (% of Earned Premium) *Catastrophe losses have varied over the last 10 years, averaging 1.3% of earned premium. Use of a long-term average for catastrophes is an appropriate adjustment in the calculation of expected return on net worth. Total exclusion of all catastrophe losses in 1985 is wrong in determining 1985 profitability for the property/casualty industry.*

13 REALIZED CAPITAL GAINS VARY OVER TIME



Realized Capital Gains (% of Assets) *Realized capital gains have grown in recent years to unprecedented levels. Use of a long-term average of realized capital gains is an appropriate adjustment in the calculation of* expected return on net worth. *Inclusion of the record levels of realized capital gains in a calculation of the 1985 return is misleading in determining potential profitability.*

ACCUSATION

Price increases are excessive. Losses are not the problem.

CHARGE: The insurance industry needed only a 12-15% increase in written premium in 1985 in order to achieve a 13-15% return on net worth in 1986. Given the magnitude of the premium increases in 1985, no additional price increases are needed in 1986.

THE FACTS: No reasonable set of assumptions could support the above statements. It is not plausible that a 12-15% premium increase in 1985 could produce such a high rate of return in 1986. This analysis cannot refute the specific assumptions or calculations underlying the critics' charges since no supporting data have been provided.

Based on an ISO analysis, if industry written premiums had increased only 12-15% in 1985, further increases in excess of 30% would be required in 1986 to achieve a 13% return on net worth. An overall premium increase of this magnitude would be far larger than any ever achieved by the insurance industry.

Given the estimated 20% premium growth that occurred in 1985, ISO forecasts there will be a smaller increase in 1986. Assuming a 17.5% increase for 1986, ISO projects that 1986 industry returns on net worth will rise. Under reasonable assumptions for loss growth, investment income, realized capital gains and taxes, the 1986 return on net worth will be only 8-9%, which is far below the typical returns for most other U.S. industries and below the median result for the Fortune 500 in each of the last 10 years.

The following facts support the ISO analysis and forecasts.

(1) Recent insurance industry returns on net worth have been low—below 2% for 1984, with modest improvement, at best, in 1985. Roughly a 10-point increase in return on net worth would be required to reach the 13-15% range hypothesized for 1986.

(2) Industry losses have continued to escalate rapidly, rising 15% in the first nine months of 1985. The full-year increase in losses will be at least as high.

The charge that no additional price increases are needed in 1986 is false. If the industry implements no increases in 1986, a return on net worth of only 5% could be expected—and 1987 returns would be even lower. The beginning of another downturn so soon after the longest and most severe downturn in the history of the industry would seriously threaten the industry's ability to make future claim payments.

CHARGE: Insurance premiums are increasing so dramatically today solely because of prior inadequate prices. Increasing losses are not the problem.

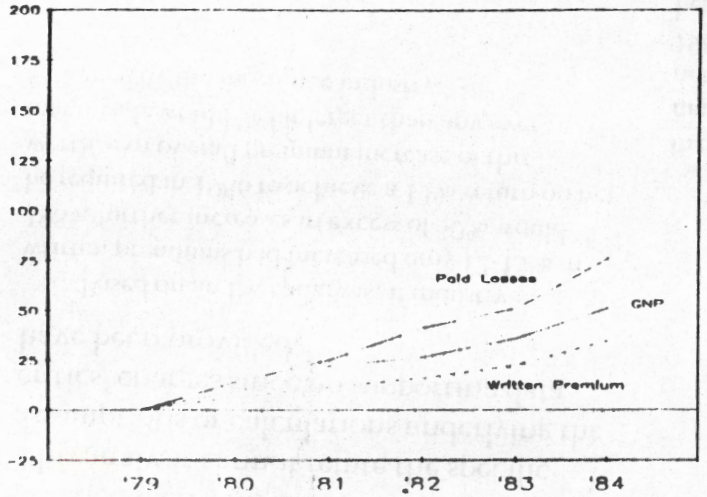
THE FACTS: This charge is incorrect. No one can deny that insurers reduced prices far below the level needed to cover the costs of policies written. However, in the past five years, growth in property/casualty losses has far exceeded the country's economic growth as measured by GNP.

During 1979-1984, GNP grew 50% while written premium increased only 34%, or 2.4 points per year *slower* than the average annual GNP growth rate. On the other hand, paid losses grew 76%, or 3.4 points per year *faster* than GNP. **(See chart 14.)**

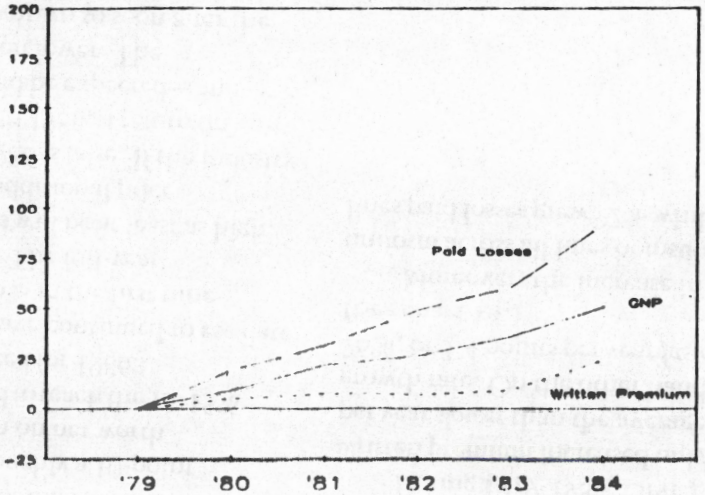
Moreover, the increase in losses was not uniform across all lines of insurance. Commercial lines paid losses grew 92% while personal lines

LOSSES GREW FASTER THAN PREMIUMS, ESPECIALLY FOR COMMERCIAL LIABILITY LINES

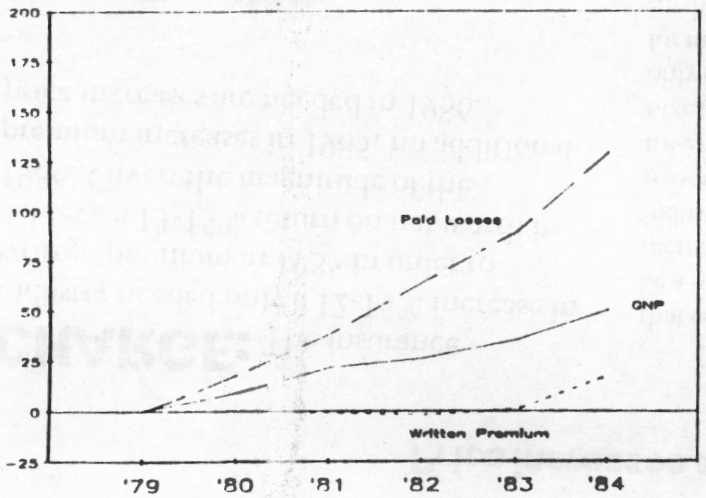
Since 1979, paid losses have grown at a faster rate than either GNP or premiums. The problem is more severe for commercial lines, especially the commercial liability lines.



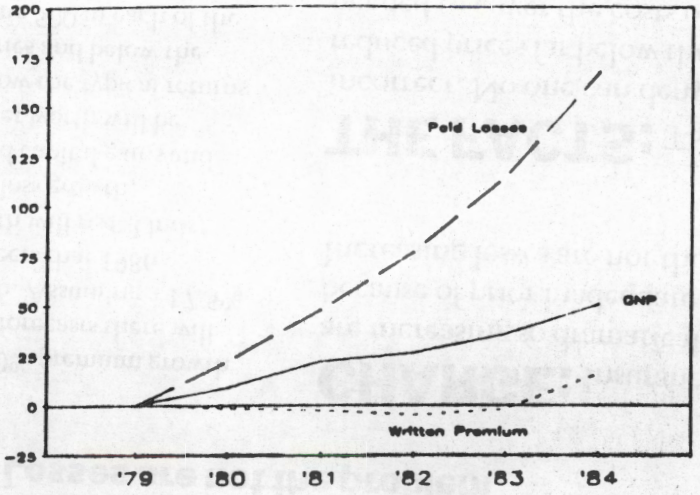
14
Loss Growth and Premium Growth vs. GNP (%): All Lines



15
Loss Growth and Premium Growth vs. GNP (%): Commercial Lines



16
Loss Growth and Premium Growth vs. GNP (%): Commercial Liability



17
Loss Growth and Premium Growth vs. GNP (%): General Liability & Medical Malpractice Combined

paid losses increased 62%, and commercial liability paid losses increased 130% during the period—well over double the GNP growth rate. **(See charts 15 and 16.)**

Finally, general liability and medical professional liability paid losses have grown 167% over the five-year period—more than triple the GNP growth. **(See chart 17.)** From 1979 to 1984, paid loss growth averaged 22% a year—13 points more than the average annual GNP growth rate. **(See chart 18.)**

The Administrative Office of U.S. Courts reports that product liability suits filed in U.S. District Courts increased from 1,600 in 1974 to more than 13,500 in 1985—a growth rate of 22% per year. **(See chart 19.)** Very large awards are becoming much more common. Jury Verdict Research, Inc. reports that the number of million-dollar verdicts in the U.S. has increased each year, from 24 in 1974 to over 400 in 1984. **(See chart 20.)**

One aspect of the problem of increasing losses is the accompanying litigation costs. The Institute for Civil Justice studied asbestos litigation and found that a disproportionate share of the expenditures on these claims does not reach the victims. Specifically, only 37% of costs in asbestos litigation become net compensation to victims. **(See chart 21.)**

While current availability and affordability problems are certainly due in part to past price reductions, a major contributor to the problems has been the significant increase in losses. From 1979 to 1984, policyholders had the benefit of low insurance price levels that did not keep pace with losses. But as a result, the insurance industry experienced below-average returns on net worth relative to the Fortune 500 companies in every year since 1979.

The large premium increases occurring now, particularly for the commercial liability lines, will not recoup past losses nor make up for recent substandard returns. Such increases are needed simply to bring insurance prices in line with the costs of policies written today.

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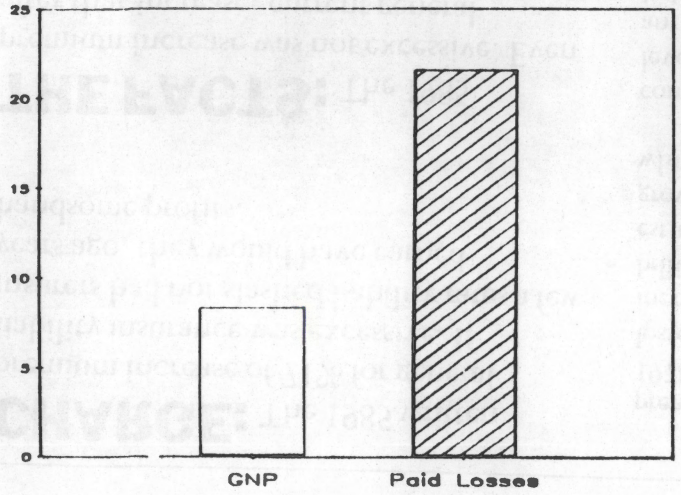
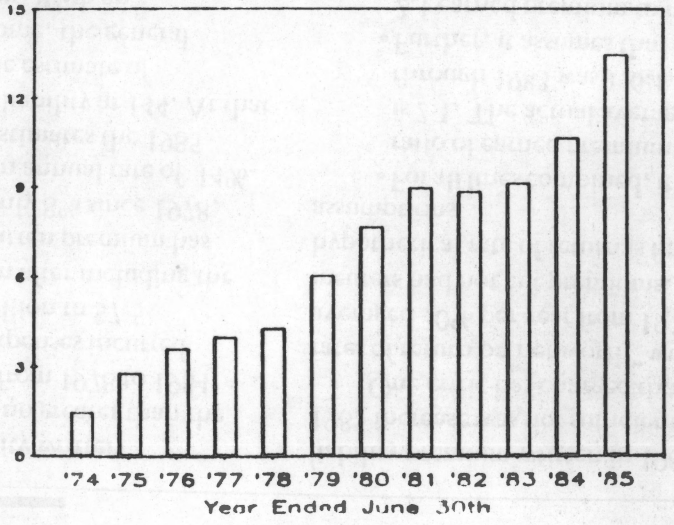
18 LOSS GROWTH OUTPACES ECONOMIC GROWTH



General Liability & Medical Malpractice Losses vs. GNP—1979-84 (Annual % Change) *For the past five years, the average rate of growth in general liability and medical malpractice paid losses was 22% vs. a 9% GNP growth rate, a 13-point annual gap.*

19 LITIGATION EXPLOSION



Product Liability Lawsuits (Thousands) *Since 1974, the number of product liability lawsuits filed in U.S. District Courts has increased more than eight-fold. Source: Administrative Office of U.S. Courts.*

CHARGE: The 1985 written premium increase of 71% for general liability insurance was excessive. If insurers had not slashed liability rates a few years ago, they would have earned handsome profits.

THE FACTS: The 1985 premium increase was not excessive. Even after that increase, current general liability premium levels are still inadequate when compared with current general liability losses.

The 1984 general liability written premium of $6.5 billion was no greater than the 1978 written premium. But from 1978 to 1984, losses and loss adjustment expenses incurred increased 74%, from $4.3 billion to $7.5 billion. (See chart 22.) Even after including the estimated 1985 increase, written premium has grown at an annual rate of only 8% since 1978, while losses have grown at an annual rate of 14%.

A.M. Best Company estimates the 1985 combined ratio[3] for general liability at 144. At that level, even with a reasonable estimate of anticipated investment income, the general liability lines will lose money. With an estimated annual 8½% interest rate, historical payout patterns for general liability and the A.M. Best combined ratio estimate for 1985, insurers lost 7¢ on every dollar of general liability premium written in 1985. Obviously, the 1985 increase was not sufficient.

One critic has charged that "general liability rates of return on net worth" would have averaged 30% per year from 1976 to 1983, if insurers had not cut premiums. This hypothetical rate of return is flawed by unrealistic assumptions.

- For all lines combined, it assumes that the ratio of earned premium to net worth is 2:1. The actual average for 1976 through 1983 was 1.6:1.
- Further, it assumes that the hypothetical 2:1 earned premium to net worth ratio is

[3]*Combined ratio = incurred losses and loss adjustment expenses divided by net earned premium* plus *other underwriting expenses divided by net written premium* plus *dividends to policyholders divided by net earned premium.*

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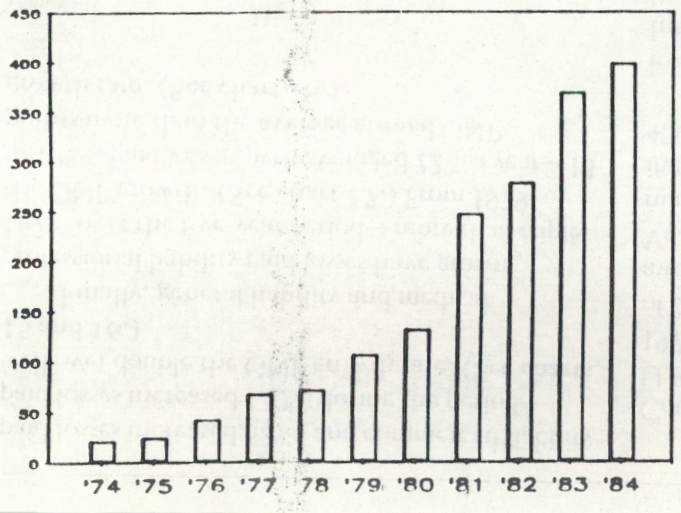
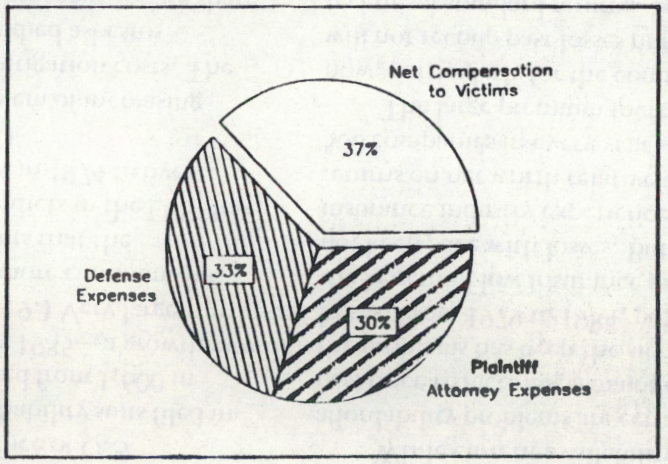
20 NUMBER OF HUGE VERDICTS INCREASING



Million-Dollar Verdicts *From 1974 to 1984, the number of million-dollar verdicts rose dramatically. Source: Jury Verdict Research, Inc., Solon, Ohio.*

21 VICTIMS RECEIVE ONLY 37% OF ASBESTOS CLAIMS EXPENDITURES



Average Expenditures per Tried Asbestos Claim (%) *The Institute for Civil Justice has found that only 37% of asbestos claims expenditures become net compensation to victims.*

the same for general liability as for all lines combined. In a line like general liability, claims remain outstanding for long periods of time while legal standards change; a prudent insurer would therefore require more net worth to support each dollar of general liability premium than for most other lines.

- In rewriting history, the critics assume that, had premiums been greater, *all* the additional premium revenue would have been profit. This assumption ignores the fact that, at a minimum, commissions and premium taxes would be paid and income taxes would rise (or credits decrease).

Thus, the conclusion that the "general liability return on net worth" would have been 30% is inaccurate.

CHARGE: Since, for medical malpractice, the industry's paid losses are less than their investment income, this line can be treated on a "pay as you go" basis.

THE FACTS: This charge has two flaws. First, the figures are inaccurate and incomplete; the industry's paid losses alone for medical malpractice are substantially greater than investment income, even without consideration of paid loss adjustment expenses. Second, even if the figures were accurate and complete, the charge is irrelevant. It is inappropriate to consider only actual payments without recognizing future liabilities for injuries that have already occurred but for which the related claims are not yet settled. For long-tail lines like medical malpractice, these claims take many years to settle.

For 1984, A.M. Best reported $970 million in medical malpractice paid losses and $440 million in paid loss adjustment expenses (monies expended in the investigation and settlement of claims), for a total of $1.4 billion.

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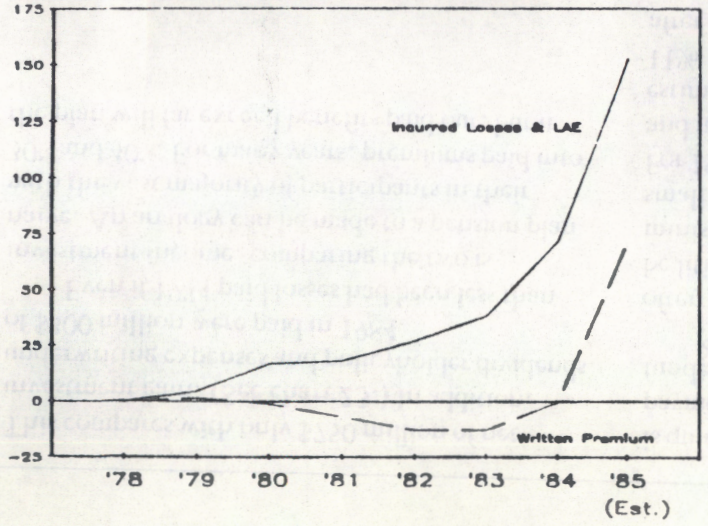
22 1985 GENERAL LIABILITY PREMIUM GROWTH NOT ENOUGH TO CATCH LOSSES



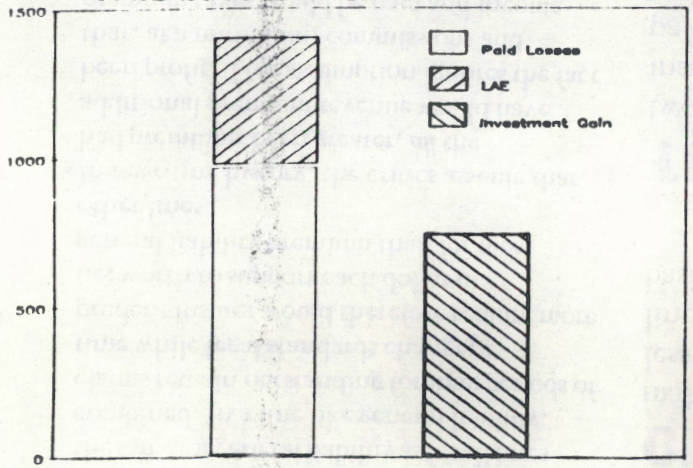
General Liability Premium Growth vs. Loss Growth (%) *1985's large premium growth for general liability was not enough to bring premiums in line with 1985 general liability losses and loss adjustment expenses. And, since 1978, the rate of growth in losses is nearly double that of premiums.*

This compares with only $750 million of net investment gain. (See chart 23.) In addition, underwriting expenses and policyholder dividends of $300 million were paid in 1984.

Even if 1984 paid losses had been less than investment income, comparing the two is naive. An analogy can be made to a pension plan with the vast majority of participants in their 30's and 40's. For many years, premiums paid into the plan will far exceed benefits paid out, but it is quite obvious that the liability for future benefit payments is growing each year and must be funded.

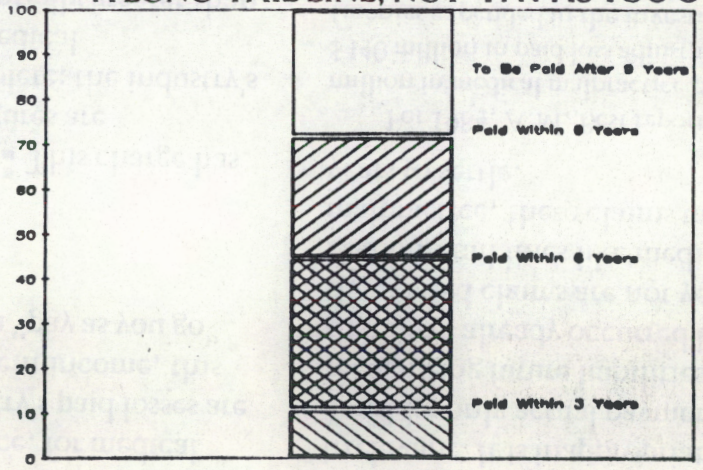
Similarly, medical malpractice claims often take years to emerge and additional years to be litigated. Claims paid out the first year are miniscule, and even after several years, only a small percent of ultimate losses are paid out. For 1976, the year for which the most complete and mature data is available, only 1% of total estimated losses were paid in the first year, only 11% in the first three years and only 72% even after nine years. (See chart 24.) The percentages are similar for other years examined. To conclude anything about the profitability of this line on the basis of paid losses is like saying that the Social Security system is properly funded simply because more money was collected this year than was paid out this year.

23 CRITICS' CHARGES FALSE: MEDICAL MALPRACTICE PAID LOSSES EXCEED INVESTMENT GAIN



Medical Malpractice Insurers' Paid Loss & Loss Adjustment Expense vs. Investment Gain ($ Millions)
For 1984, investment gain for medical malpractice insurance is significantly lower than loss and loss adjustment expenses paid. Critics falsely contended the opposite.

24 MEDICAL MALPRACTICE INSURANCE: A LONG-TAIL LINE, NOT "PAY AS YOU GO"



1976 Medical Malpractice Claims: Percent of Ultimate Losses Paid
After nine years, only 72% of 1976 medical malpractice losses were paid. Claims often take years to emerge and additional years to litigate.

ACCUSATION

Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.

CHARGE: The stock index of property/casualty insurers rose by 50% during 1985, almost double the rise of the general stock market. This is hardly indicative of a troubled industry.

THE FACTS: The fact that property/casualty stock prices, as measured by the A.M. Best Company's property/casualty stock index, outperformed the rest of the stock market is no indication that this industry is profitable. Investors expect improvements in rates of return for property/casualty insurers but investor expectations are merely that—*expectations*. They do not guarantee results.

Signs of a firming in insurance premiums (especially for commercial lines) began to emerge at the end of 1984. This price strengthening continued throughout 1985 and shows no sign of abatement in 1986. It is clear that sophisticated institutional investors believe that insurers have regained control of their financial destinies and that earnings will improve. But investor expectations do not guarantee future results, and investor behavior does not necessarily correlate with future earnings of the industry.

CHARGE: Property/casualty insurers had net income of $75 billion over the last 10 years. This is a huge amount of money to make. And they paid no taxes.

Note: The $75 billion figure in the critics' charge is based on a fact sheet prepared for the House Ways and Means Committee by the General Accounting Office. The GAO produced a chart that contained the following figures for the property/casualty insurance industry.

1975-1984 (in billions)

Underwriting Gains (Loss)	($ 45.8)
Investment Gains	121.0
Net Gains	$ 75.2

THE FACTS: The $75 billion figure is not net income. It *excludes* policyholder dividends paid and *includes* unrealized capital gains. Net income after taxes averaged $5.1 billion per year, for an average return on net worth of 10.9%. The 10.9% figure is lower than that of the Fortune 500 companies. And insurers' tax credits are based on underwriting losses and the tax status of their investments.

Some critics have used the GAO's figures to reach erroneous conclusions. The underwriting loss shown excludes policyholder dividends paid, and since policyholder dividends are a cost of doing business, they must be deducted from income. (See page 20.)

Investment gains, as shown, include unrealized as well as realized capital gains. Unrealized capital gains flow directly to surplus and do not affect income until realized. A restatement of the 1975-84 totals, with the proper adjustments for policyholder dividends and unrealized capital gains, follows:

PROPERTY/CASUALTY INSURANCE INDUSTRY INCOME, 1975-1984 (in billions)

Underwriting Gain (Loss) After Policyholder Dividends	($ 60.0)
Investment Income	103.7
Operating Income	$ 43.7
Realized Capital Gains	7.7
Net Income (Before Federal Income Tax)	$ 51.4

Property/casualty insurers received a total of $125 million in federal income tax credits during 1975-1984. Thus, industrywide net income after tax for the 10-year period averaged $5.1 billion per year, not an excessive return. Over the 10-year period 1975-1984, returns on net worth ranged from 1.7% to 19.0%, averaging 10.9%. A comparison with other industries follows:

RETURNS ON NET WORTH, 1975-1984

	P/C Insurance	Diversified Financial	Banks	Fortune 500
Low:	1.7%	8.3%	11.5%	10.7%
High:	19.0	17.5	14.1	15.9
Range:	17.3	9.2	2.6	5.2
Average:	10.9	12.8	12.6	13.2

The property/casualty insurance industry has had the lowest average return, while experiencing the greatest variability of all the industries listed. (See chart 25.) This occurs despite the economic theory that increased variability should be rewarded with greater average returns.

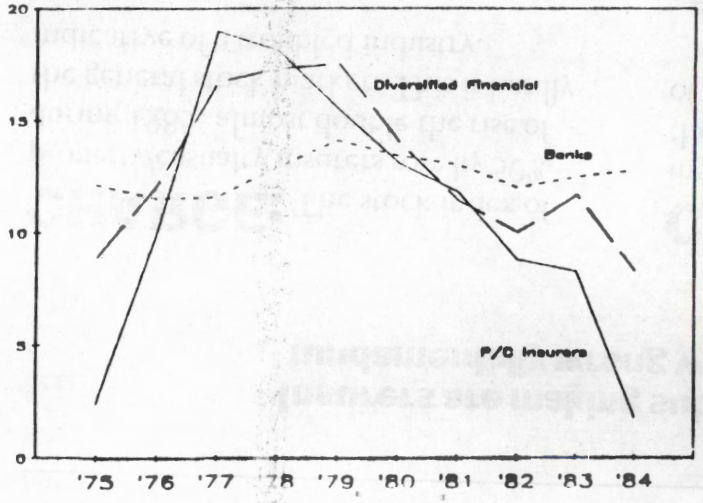
While some critics have argued that the property/casualty insurance industry is a low-to-average risk business, the Majority Report of the Advisory Committee to the NAIC Task Force on Profitability and Investment Income (January 1983) concluded that "the property-casualty insurance business is riskier than the average business in the American economy."

Although property/casualty insurers received a total of $125 million in federal income tax credits during 1975-1984, they paid $21 billion in state and local taxes, licenses, and fees other than payroll taxes. The 1985 federal income tax credit is estimated at under $2 billion, while state and local taxes paid are estimated at over $3 billion.

Net federal income tax credits have accumulated for several reasons. In eight of the past 10 years, the industry posted underwriting losses. Since the 10-year underwriting loss was $60 billion, the positive net income of $51 billion came from investment gains. In achieving this income, property/casualty insurers, like other businesses, benefited from various incentives provided by the federal tax system to help the country achieve certain economic objectives.

For example, to help state and local governments raise money through the sale of bonds, Congress has determined that interest

25 INDUSTRY RETURNS ARE VOLATILE OVER TIME



Return on Net Worth: Property/ Casualty Insurers vs. Other Industries (%) *Returns on net worth for property/ casualty insurers are much more variable than those for other industries. Over the past 10 years, the average rate of return for property/casualty insurers (10.9%) has been below that of the Fortune 500 companies (13.2%), while exhibiting much more variation.*

on such bonds is exempt from federal taxes. This enables such bonds to be sold with interest rates below the market rate, reducing interest costs ultimately paid by state and local taxpayers. Insurers could have earned higher interest income (on taxable bonds) and paid taxes on that interest income, inflating their federal tax bills but leaving state and local governments without a source of low-cost financing.

Over the last six years, 40% of the industry's net investment income has come from non-taxable bonds. Favorable tax treatment also exists for dividends on equities held by insurers, which have accounted for 20% of the industry's net investment income. In addition, property/casualty insurers (like all investors) benefited from reduced tax rates on realized capital gains.

It is inappropriate to criticize insurers for acting in compliarce with tax laws and public policy.

XIV

CHARGE: This is a typical cycle. The property/casualty industry will recover quickly, just as it has in past cycles.

THE FACTS: This cycle is clearly not typical. The results of the recent past demonstrate that the industry is experiencing anything but a "typical" cyclical period. Underwriting losses, operating losses, combined ratios, the number of insolvencies and the number of companies targeted for immediate regulatory attention were all at record highs in 1984, while the industrywide return on net worth was at an all-time low. And reinsurers, on whom insurers depend as never before, have been seriously weakened.

The 1984 underwriting loss was $21.5 billion. Prior to this cycle, the record underwriting loss was $4.2 billion in 1975. **(See chart 26.)** The 1984 operating loss was $3.8 billion. The previous record was $0.3 billion in 1975. **(See chart 27.)** The 1984 combined ratio was 118.0. Prior to this cycle, the record was 107.9, again in 1975. **(See chart 28.)**

In 1969, the National Committee on Insurance Guaranty Funds began to collect data on insolvencies that trigger state guaranty funds. Until last year, the record number of insolvencies in any two-year period was 25. During 1984-85, there were 40 insolvencies; and the books on 1985 insolvencies are not yet closed. **(See chart 29.)**

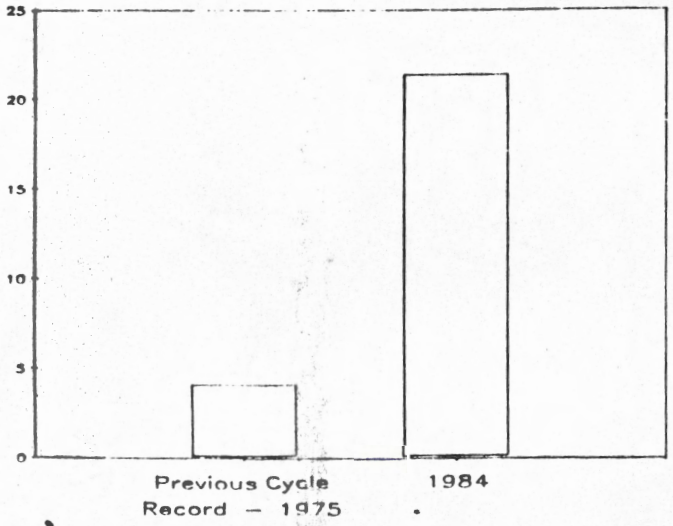
The National Association of Insurance Commissioners (NAIC) developed an early warning system to alert regulators to potential insolvencies. In discussing the 1985 test results, Iowa Insurance Commissioner Bruce W. Foudree, former President of the NAIC, said that 215 property/casualty insurers had been targeted as being in need of immediate regulatory attention under the NAIC early warning system—"the most ever and a 73% increase over last year."

On the basis of bottom-line results, the 1984 return on net worth was 1.7%, despite a record $4.8 billion of realized capital gains and tax credits. The previous low return on net worth of 2.4% occurred in 1975, when the sum of tax credits and realized capital gains was only $0.7 billion.

One of the most important differences between this down cycle and all previous ones is its length. This time, the combined ratio worsened for seven consecutive years beginning in 1978. Previously, the longest continuous

A TYPICAL CYCLE?

By several measures — underwriting loss, operating loss, combined ratio, and insolvencies — it is clear that the cycle that bottomed in 1984 was far more severe than any previous one.



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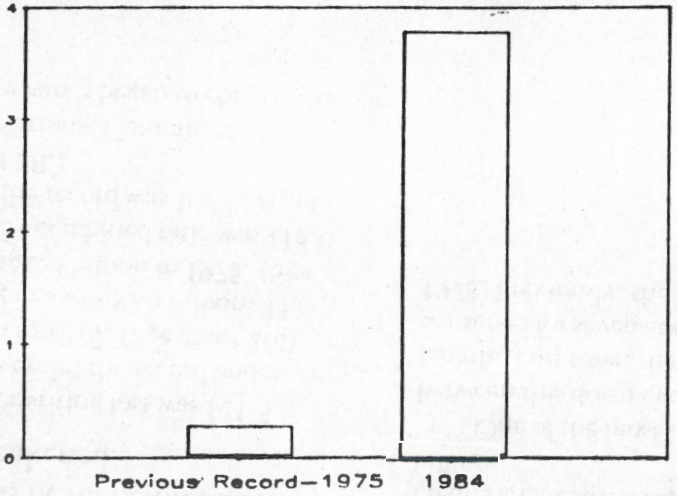
Underwriting Losses ($ Billions)



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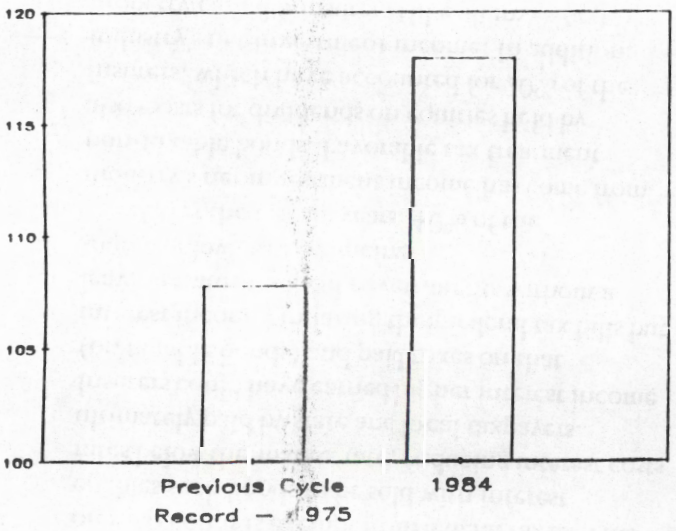
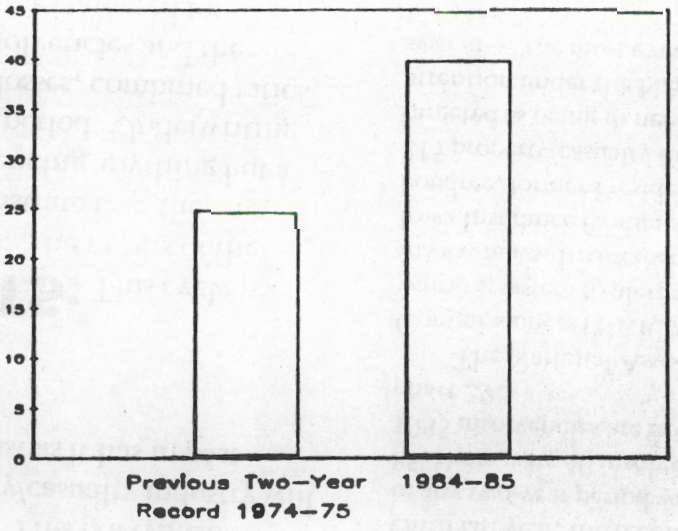
Operating Losses ($ Billions)

72X



28

Combined Ratios



29

Insolvencies Covered by State Guaranty Funds

period of deteriorating combined ratios was for the five years 1960 through 1964. During that period, however, the combined ratio worsened by only five points; in this cycle, it deteriorated by 21 points.

Another indicator of the depth of this cycle is the number of insurers receiving reductions in any year from their A.M. Best rating of A+. That number increased from 23 in 1982, to 61 in 1983, to 80 in 1984 and finally to 149 in 1985. **(See chart 30.)** In 1985, only 24% of the companies rated received an A+, compared with an average of 39% in 1976 and 1977 following the last adverse underwriting cycle.

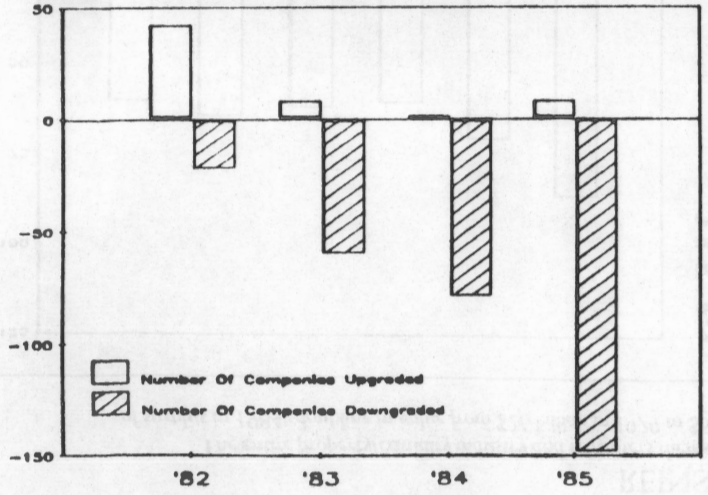
The property/casualty insurance industry is now more dependent on the reinsurance mechanism[4] than ever before. During 1979-1984, reinsurance recoverable (monies owed to insurers by their reinsurers) more than doubled, while surplus grew 50%. **(See chart 31.)** For reinsurers themselves, the amount recoverable from their reinsurers more than tripled during this period, while their surplus grew 73%. **(See chart 32.)** During this period, premiums for the industry increased 30%, while reinsurance premiums increased 54%. At the same time as dependence on reinsurance rapidly increased, reinsurers' financial condition seriously eroded. The 1984 return on net worth for the entire insurance industry was nearly 2%, while it was *negative* 10% for reinsurers. In 1985, A.M. Best lowered the ratings of half the reinsurers rated.

For the past two decades, reinsurers' combined ratios have closely paralleled those of the property/casualty industry with the gap never exceeding 4½ points, except for the 6-point gap in 1965, the year of Hurricane Betsy. **(See chart 33.)** As recently as 1982, the two combined ratios were only one-tenth of a point apart. The gap grew to 6 points in 1983 and then to 13 points in 1984. Although this gap has begun to narrow in 1985, reinsurer combined ratios are still substantially worse than those for the entire property/casualty industry.

Historically, personal and commercial lines results have been similar. Between 1967 and 1982, the difference between the combined ratios never exceeded 6 points. **(See chart 34.)** As recently as 1981, the ratios were only 2 points

[4] *For a more thorough discussion of reinsurance, see the Appendix.*

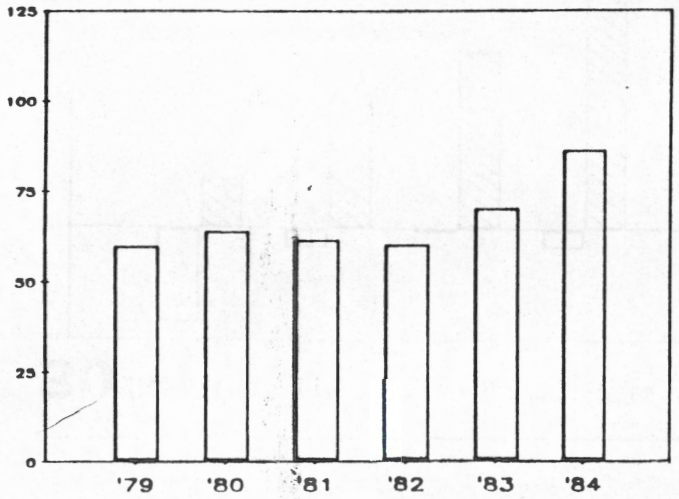
30 INSURERS' FINANCIAL RATINGS DOWNGRADED



A.M. Best's A+ Rating Reductions
A.M. Best's highest rating is an A+, which it gives to companies that it considers to be the most financially secure. In the last two years, A.M. Best has removed 229 companies from this category, while upgrading only 11.

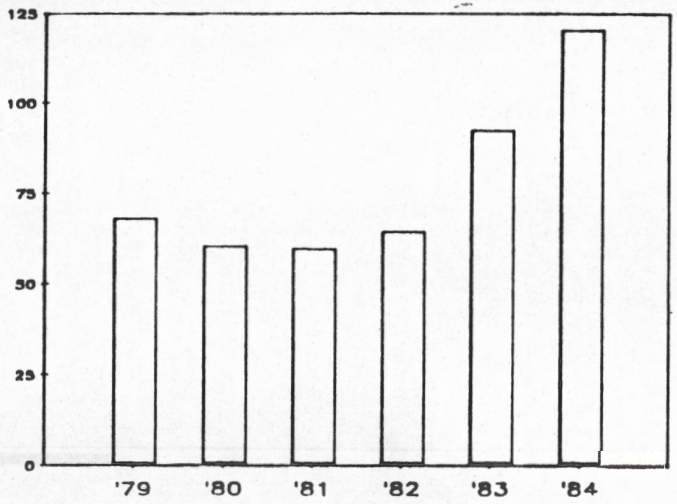
REINSURANCE RECOVERABLES GROWING

The entire property/casualty industry and reinsurers themselves have become more dependent on reinsurance. For the industry, reinsurance recoverable represented 85% of surplus in 1984, doubling in value from $26 billion in 1979 to $55 billion in 1984. For reinsurers, recoverables represented 120% of surplus in 1984, tripling in dollar value since 1979.



31

Industry Reinsurance Recoverable (% of Surplus)

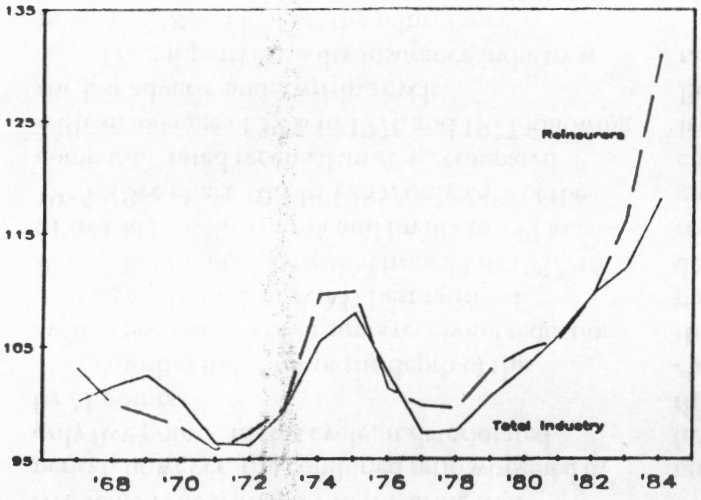


32

Reinsurers' Reinsurance Recoverable (% of Surplus)

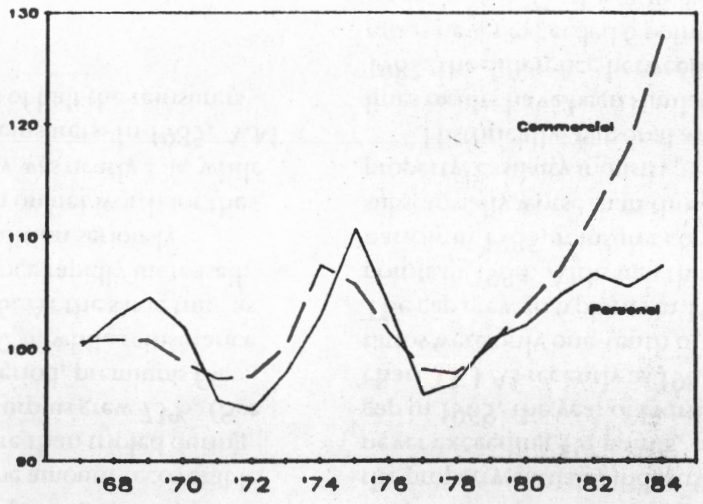
DETERIORATION GREATEST IN COMMERCIAL LINES AND REINSURANCE

Reinsurers have experienced significantly more severe combined ratios than the industry as a whole since 1983, a marked contrast to past cycles. Likewise, commercial lines combined ratios have skyrocketed recently, while those for the personal lines have been more stable.



33

Combined Ratios: Reinsurers vs. Total Property/Casualty Industry



34

Combined Ratios: Personal Lines vs. Commercial Lines

apart. Then in 1983, the gap grew to 12.5 points. In 1984, when it grew to over 20 points, those insurers writing predominantly commercial lines had a negative return on net worth. In 1985, the gap l gan narrowing but still stood at nearly 15 points for the year ended September 30, 1985.

An even greater concern for commercial lines insurers and reinsurers is that their combined ratios may be understated due to reserve inadequacy. Because of this, the combined ratios for these insurers could be worse than the record highs recorded.

Richard E. Stewart, former Superintendent of Insurance of the State of New York, discusses the current cycle in a December 1985 Marsh & McLennan *Commentary* article. In it, he writes, "...this is not just a routine turn in the underwriting cycle. It has structural as well as cyclical causes." He further notes, "Whereas economic inflation drove the casualty insurance crises of the mid-seventies, the current one is driven by terrible events and by changes in liability law." And he adds, "Insurance has met liability problems before. These are liability disasters. No exclusion is reliable, no excess level out of reach."

All these elements strongly support the conclusion that this is not just a "typical cycle" for the property/casualty insurance industry. Because reinsurers and commercial lines insurers have been hit harder, premium increases will fall unevenly, with some commercial liability policyholders experiencing very large increases. Because the industry's downturn lasted longer than ever before and because the depth of the downturn was worse than ever before, the recovery must be longer and stronger in order to achieve an adequate level of profitability for the industry.

ACCUSATION

Insurance is too expensive.

CHARGE: The total insurance bill in the U.S. will rise from 11.1% to more than 12% of disposable income in 1985—more than $300 billion—displacing personal federal income taxes as the third largest expense in the nation's budget. Only food and housing cost Americans more than insurance.

THE FACTS: These statistics are misleading. The $300 billion figure includes life, health, and accident insurance premiums as well as all property/casualty insurance premiums. The costs of life, health and accident insurance do not belong in a discussion of property/casualty insurance. Moreover, the inclusion of business insurance expenses is inappropriate when making comparisons to disposable income, which is a measure of personal income only.

Personal lines insurance premiums (for private passenger automobile and homeowners insurance) are estimated to be $64 billion in 1985, which would represent 2.3% of disposable income, the amount of 1985 personal income after taxes.

Insurance is not even the largest expense associated with owning either a car or house. In 1984, the Federal Highway Administration conducted a study on the cost of owning and operating typical vehicles in suburban Baltimore, Maryland. The study concluded that insurance was the third largest cost—behind vehicle cost depreciation, and gas and oil for most cars. For large and compact cars, it ranked fourth—behind vehicle cost depreciation, gas and oil, and also maintenance, accessories, parts and tires.

A 1983 countrywide study by the U.S. League of Savings Associations showed that the cost of insurance represents less than 3% of the monthly housing expenses faced by home purchasers in the United States. Insurance costs came in fourth—behind mortgage payments, real estate taxes and utilities.

There are many items that cost Americans more than insurance. One way to analyze relative costs is to examine the components of the nation's personal consumption expenditures, which are included in GNP. According to the Department of Commerce, personal consumption expenditures represent the market value of purchases of goods and services by individuals and non-profit institutions and the value of food, clothing, housing, and financial services received by them. Therefore, the components of personal consumption should be compared with personal lines premiums as follows:

1985 AMOUNT SPENT ($ BILLIONS)

PERSONAL CONSUMPTION COMPONENT	
Food & Beverages	474
Housing	403
Motor Vehicles & Parts	168
Clothing & Shoes	156
Furniture & Appliances	129
Gasoline & Oil	92
INSURANCE PREMIUMS	
Personal lines insurance premiums[5]	64
Total property/casualty insurance premiums	142

The table indicates six components which are a greater proportion of consumer spending than property/casualty personal lines premiums.

[5]It should be noted that personal lines insurance premiums do not include premiums written on non-profit institutions. However, inclusion of premiums written on non-profit institutions with personal lines premium would have a minor impact and would not raise the total above any of the six personal consumption items listed above.

CHARGE: Property/casualty insurance premiums written rose by $24.6 billion in 1985, from $117.7 to $142.3 billion, while coverage decreased substantially. This works out to an increase of $105 per person for substantially less coverage.

THE FACTS: These figures are misleading. A.M. Best's estimate of the $24.6 billion increase is for all property/casualty premiums, not just personal lines premiums.

Personal lines premium (for the coverages purchased by individuals to protect their autos and homes) increased $6.7 billion, or 11.7% in 1985, an increase of $28 per person, not $105. The 11.7% increase in personal lines premiums in 1985 approximated the 13% increase in personal lines losses. ISO estimates that personal lines paid losses and loss adjustment expenses increased $5.5 billion in 1985, equivalent to an average $23 payment per person. After all losses and expenses, insurer underwriting loss for personal lines was over $1 billion more in 1985 than in 1984.

There do not appear to be significant marketplace problems in the personal lines. Large premium increases are the exception rather than the rule, and restrictions in coverage have been rare.

Most of the 1985 written premium increase was in commercial lines, which increased $17.8 billion or 30%, as the industry reacted to the growth in losses for these lines.

These increases in commercial l
costs are a matter of concern, since th
outpacing the costs of other goods an
is precisely this point that has led ind
leaders, businesspersons, legislators, r
consumers to investigate methods of
the upward spiral in insured losses.

APPENDIX

DISCUSSION OF REINSURANCE

Reinsurance is essentially an insurance transaction whereby the reinsurer, for a premium, agrees to indemnify the ceding insurer or reinsured against all or part of the loss which the latter may sustain under its policies of insurance. It is often described as the insurance of insurance companies because it provides reimbursement for an insurer's losses under policies covered by the reinsurance contract. Reinsurance is purchased by the primary or excess ceding insurer for its own benefit so that it can spread its risks and limit its own liability from large or catastrophic losses. The usual reinsurance contract does not involve the policyholder, who looks only to its insurer for defense and indemnity against loss.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry. In addition to capacity, reinsurance is purchased by a primary insurer to (1) reduce exposure to liability on particular risks, (2) protect against accumulations of losses arising out of catastrophes, (3) reduce total liabilities to a level appropriate to its premium volume and capital, (4) reduce exposure to certain and possibly more hazardous lines of business or alter its "mix" of business, (5) help stabilize operating results, and (6) obtain assistance with new concepts and lines of insurance.

Reinsurance contracts are shaped to meet the specific needs of the ceding insurer . . . There are no standard reinsurance contracts; there are two basic types which are used and adapted to accommodate the buyer's business. A reinsurance *treaty* is a broad and often automatic agreement that covers some portion of a particular class or classes of business, i.e., the ceding insurer's entire workers' compensation or property book of business. In contrast, a *facultative* agreement covers a specific risk of the ceding insurer and requires the insurer and reinsurer to agree on terms and conditions on a contract-by-contract basis. Both treaties and facultative agreements may be based on a *pro-rata* distribution where the two parties share proportionately in premiums and losses. The agreements may also be written on an *excess* basis, where only the losses of the insurer in excess of a predetermined amount, known as the "retention", are reinsured.

Reinsurance Association of America statement before the House Subcommittee on Commerce, Transportation and Tourism, September 19, 1985.

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February 12, 1986

Insurance Services Office Inc.
125 Maiden Lane
New York, NY 10038

Gentlemen:

You have requested our opinion on the appropriate accounting by property and liability insurance companies for (1) dividends to policyholders and (2) realized gains and losses on investments. Our opinions expressed herein do not relate to assessment enterprises or fraternal benefit societies which may employ different accounting principles.

Generally accepted accounting principles for property and liability insurance companies are set forth in the Statement of Financial Accounting Standards No. 60 (the Statement), "Accounting and Reporting by Insurance Companies". The Statement contains the guidance for our views on the transactions set forth above which are:

X6L

Dividends to Policyholders

In our opinion, generally accepted accounting principles for property and casualty insurance companies require that dividends to policyholders be charged to operations.

Realized Gains and Losses on Investments

In our opinion, generally accepted accounting principles for property and casualty insurance companies require that realized gains and losses on all investments (including, but not limited to, stocks, bonds, mortgage loans, real estate and joint ventures) be reported in the income statement below operating income and net of applicable income taxes.

Very truly yours,

Coopers & Lybrand

INSURANCE AVAILABILITY

An Industry View

Alliance of American Insurers
American Insurance Association
National Association of Independent Insurers

Originally Issued
December 6, 1985

Revised
February 24, 1986

80X

INTRODUCTION

For the first four years of this decade, most buyers of commercial and professional liability insurance enjoyed stable or decreasing insurance premiums. Then, in early 1985, premiums turned upward, often precipitously, and some buyers found it difficult to obtain adequate coverage at prices they regarded as affordable. The "availability crisis", so called, has been extensively covered by the media, and there have been proposals from many quarters as to what to do about it, ranging from voluntary efforts by insurers and agents to fundamental tort reform.

The insurance industry believes that it is critically important that efforts to solve availability and affordability issues be grounded in a sound understanding of the private insurance mechanism and the impact that the liability system* has on it. Accordingly, this paper describes the reasons for the recent escalation in commercial and professional insurance premiums and sets forth seven actions, some voluntary and some requiring regulatory or legislative approval, that can lead towards an easing of problems of availability and affordability. The paper also cautions that ill-conceived measures, such as a return to administered pricing or the adoption of involuntary market mechanisms, may impede the return of the insurance industry to financial health and thus operate to the detriment of consumers in the longer run.

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*As used in this paper, "the liability system" means the whole panoply of substantive and procedural rules by which losses are transferred from one party to another. It also includes the mechanisms through which disputes are resolved in court or otherwise, including judicial decisions with respect to insurance contracts.

Together, the Alliance of American Insurers, the American Insurance Association and the National Association of Independent Insurers (hereinafter called "the trades") represent 841 companies that write 60% ofall direct personal and commercial lines premiums in the United States and 62% of all commercial lines premiums.

The trades acknowledge the extensive help of the Insurance Services Office in providing information and statistics for this paper, and in consulting generally as to its contents.

FINANCIAL RESULTS

1984 was the worst year ever for the U.S. property-casualty insurance business. Pre-tax operating income (the combination of investment income and underwriting results) plunged to a negative $3.8 billion. The 1984 financial result was the culmination of an unbroken string of underwriting losses that began in 1979. Underwriting losses grew at an average annual rate of $3 billion through 1983 and then jumped by $8 billion in 1984. Total underwriting losses for the 1979-1984 period were $55 billion.

Until 1983, growing investment income, fueled by high interest rates, was able to offset underwriting losses. But in 1984, a modest 10.6% increase in investment income ($1.7 billion) was not able to overcome a substantial increase of $8 billion in underwriting losses, and the industry sustained the largest net operating loss in its history.

In 1984, there were underwriting losses of $16.8 billion in commercial and professional lines. These losses were 79% of all underwriting losses in 1984, whereas premiums for commercial and professional lines were only 51.3% of total industry premiums. In contrast, personal and commercial lines have historically had closely parallel loss ratios.

General liability (combined ratio:* 152) and medical malpractice (combined ratio: 170) were especially hard hit. The combined ratios mean

*The combined ratio is the ratio of incurred losses, loss adjustment expenses and policy holder dividends to earned premiums plus the ratio of underwriting expenses to written premiums.

83x

that actual expenditures and incurred obligations exceeded earned premium income by 52% and 70%, respectively, in these lines. Total underwriting losses in 1984 were $3.2 billion for general liability and $1.2 billion for medical malpractice. These underwriting losses of $4.4 billion for general liability and medical malpractice were 21% of all underwriting losses in 1984, whereas premiums for these lines were only 7% of total industry premiums. Under the most optimistic assumptions, investment income available in the market today falls far short of making up underwriting losses of this magnitude.

In 1983 and 1984, reinsurers were hit even harder by losses than the direct market. Historically, reinsurers' combined ratios closely paralleled those of the industry as a whole. In 1983, however, reinsurers had a six point higher combined ratio than the direct market (118 as opposed to 112), and in 1984, the reinsurers' combined ratio was ten points higher (128 as opposed to 118).

Although the overall combined ratio for the industry declined from 118 in 1984 to 117 in 1985, and the combined ratio for commercial lines declined from 128 to 123 for the same period, the industry nonetheless sustained a net operating loss of $5.5 billion in 1985. This was nearly 45% higher than the net operating loss for the prior year.

THE CONSEQUENCES

These escalating financial losses had the following consequences:

- a decrease of 2.5% in the aggregate policyholder surplus of the industry in 1984.* This is an unsatisfactory situation because the industry must continually increase surplus if it is to be able to support the demands of a growing economy for insurance. In fact, a study by the Insurance Services Office projects a significant capacity deficit in the next three years, almost all of it in commercial lines.

- a plunge in the industry's annual rate of return on net worth to 1.7% in 1984. The rate of return on net worth was actually negative for 50 of the top 100 insurer groups. While the industry's annual rate of return recovered to 5% for the first six months of 1985,** it is still almost ten percentage points below the average rate of return for the Fortune 500 companies.

- the partial or total withdrawal of major reinsurers in the United States, Britain and Western Europe from difficult U.S. liability lines (for example, environmental pollution and asbestos containment contractors' liability).

- a significant increase in the number of companies found to be financially impaired. In 1984, regulators found 20 companies to be insolvent. In 1985, an additional 20 companies have become insolvent. In addition, companies representing more than 20% of industry's premiums have failed at least four "early warning" tests established by the National Association of Insurance Commissioners.

* Surplus increased by 12% in 1985 as the result of investment income that was 13% higher than in 1984 and new capital of $5 billion reflecting investor expectations of future profitability.

** Rate of return on net worth was approximately 2.7% for all of 1985.

85x

In sum, severe recent losses have produced less capacity to write insurance and an increased number of companies that are insolvent or facing major financial difficulties.

The financial condition of the U.S. property/casualty industry in 1984 necessitated large and widespread premium increases in liability lines and reduced the availability of coverage for commercial and professional buyers. Underwriters also became more cautious in deciding what terms to offer to which buyers. In some liability lines, by the spring of 1985, liability insurance was not available at any price to some buyers in some lines of insurance, either through the admitted market or the surplus lines market. Buyers for whom availability has been particularly a problem in 1985 include: day care center operators; municipalities; nurse-midwives; toxic waste facility operators; and dram shops.

By and large, liability lines -- and especially those where shortages of capacity developed -- present the greatest risk of losses, just at the time when the commercial insurance industry desperately needs predictable, manageable business in order to create stability and reasonable profits as a basis for expanding its capacity.

In the 1980-84 period, as events turned out, insurance companies seriously underpriced their products. The warning signs were there as the frequency and severity of losses increased. But it took net losses in 1984 to bring home to the industry the absolute necessity of substantial price increases and selectivity in underwriting. In part, underpricing was due to the vigorous competition among insurers during that period for premium income to employ at high yields in financial markets. But the decisive factor in underpricing was the inability of underwriters to predict with any

degree of accuracy the losses they would eventually be required to pay. The expansionist, almost capricious nature of the liability system and the costs this would eventually entail were seriously underestimated by insurers.

EXPANSION OF THE CIVIL LIABILITY SYSTEM

As recently as twenty years ago, the tort law was a tightly configured system of rules under which losses were transferred from fault-free plaintiffs to clearly identified, negligent defendants. Causation was strictly construed, and latent injury claims were a thing of the future. The organizing principles of the liability system were the fairness of shifting losses where clear negligence could be shown and the general deterrence of others that was thought to result. Compensation of victims was important, but it was to be accomplished under a standard of fairness to all parties.

Today, things are far different. Negligence has been eroded or done away with as a standard, and assumption of the risk and contributory negligence have all but disappeared. Causation requirements have been overcome by judicial or statutory presumptions, and mass torts (usually with a long gestation or latency period) are now commonplace. In most areas of the country the size of jury awards has grown over the past ten years at a much greater rate than inflation, and the frequency of lawsuits has increased precipitously.

Individuals and groups differ as to the desirability of these changes. But their impact on the property-casualty industry is clear. Costs are way up and over time must be adequately reflected in premiums. More fundamentally, the industry has great difficulty in predicting its

losses and making adequate provision for them. The unpredictability and costliness of the liability system, as it has evolved, bear a direct relationship to the current problems with availability and affordability.

A detailed discussion of all of the changes in the tort system in recent years that have affected insurance availability and costs is beyond the scope this paper. A few examples, however, will illustrate the scope and complexity of the problem:

- An "entitlement" psychology has become deeply rooted in American society. This encourages adversarial proceedings and a feeling that every "wrong", no matter how defined, should be put right by somebody.

- The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) imposes a regimen of strict, joint and several liability for the costs of toxic waste clean-up. Through judicial interpretation, CERCLA applies retroactively to conduct occurring before its enactment in 1980. Moreover, one or more defendants, among many potentially responsible, may be held solely or disproportionately accountable for damages through rigorous application of the doctrine of joint and several liability.

- There has been an erosion of traditional fairness doctrines that found liability based on what the defendant knew or should have known when he acted or failed to act (Beshada v. Johns Manville, 91 N.J. 191 (1982). In Beshada, a manufacturer was held liable even though its conduct at the time it performed met all of the best available scientific and technical standards.

- There has been a gradual shift from traditional requirements that responsibility must be proved against particular, identifiable defendants to theories of enterprise liability Sindell v. Abbott Laboratories, 26 Cal.3rd 588 (1980).

- Insurance contracts, have increasingly been ignored, even when the language is clear. The most egregious recent example is Jackson Township v. Hartford Accident & Indemnity, 186 N.J. Super.156 (1983), in which the pollution exclusion in a standard comprehensive general liability policy was read against clear policy language

88x

and intent to include coverage for the gradual seepage of pollutants from the insured's land.

- Relative to indemnity to claimants, the costs of resolving disputes have risen astronomically. Illustrative of this is the growth in loss adjustment expenses, of which 90% are legal fees. As a percentage of damages, allocated loss adjustment expenses have risen from less than 15% in the late 1950s to almost 34% in 1983. A special ISO study indicates that costs may well approach 50% of the ultimate settlement value for claims reported in the last three years. A study by the Institute for Civil Justice finds that only 37 cents of every $1 expended in litigating asbestos claims reaches claimants.

INDUSTRY PROPOSALS

In the light of the expansion of the liability system, the insurance industry firmly believes that there will be no permanent and satisfactory solution to problems of insurance availability and affordability in commercial lines until changes are made in the liability system. From the perspective of the insurance industry, these changes must restore predictability to the process of assessing liability risks and permit the resolving of disputes more economically and expeditiously.

Until lasting, structural changes to the liability insurance system can be made, the industry recognizes that it has a responsibility to respond to the needs of the insurance-consuming public, both in decision-making by individual companies and in collective discussions on public policy issues with legislators and regulators.

In order to meet insurance availability and affordability problems in the short term and longer range, the Alliance of American Insurers, the American Insurance Association and the National Association of Independent Insurers offer the following seven proposals.

1. Reasonable Limitations on the Cancellation or Non-Renewal of Commercial Insurance Policies

The industry acknowledges the need for reasonable limitations that cover individual and block policy cancellations; notice of changes in policy terms; and notice of non-renewal. The industry believes that a reasonable balance should be struck between the buyer's need for stability and time to react if changes are necessary on the one hand, and the insurer's need for a degree of flexibility to respond to changes in the individual risk or impairments in the financial status of the insurer or its reinsurers.

2. Voluntary Market Mechanisms

Many in the industry have been and are working actively with regulators and producers to broaden the availability of coverage in such difficult lines as day care and liquor liability. Provided that regulators and others understand that a market assistance plan is not a panacea, and that there are lines in which the volatility and dimensions of the underlying exposure make voluntary efforts difficult if not impossible to undertake, the industry is ready to continue its work with individual regulators, under their leadership, to maximize the opportunities to write difficult lines in the private market.

An additional virtue of voluntary efforts is that they can rather quickly document the extent and characteristics of the problem, so that further steps, if any are needed, can be considered in the light of documented facts. In this connection the industry supports the establishment in states of telephone "hot lines" by the commissioner or

an industry group so that information as to insurance needs and available sources of insurance can be exchanged efficiently.

Voluntary plans also enable insurers to review the loss control procedures of difficult-to-insure commercial buyers and make helpful suggestions. By minimizing hazards through a loss control plan, the buyer may be able to provide a potential insurer with the assurance necessary to provide desired coverage.

3. Insurance Availability Clearinghouse

To help regulators identify admitted and surplus lines carriers that may currently be writing lines in which capacity is short, the industry proposes that a clearinghouse be established. This clearinghouse would help identify and define availability problems in the several states, provide information about markets for difficult lines and recommend regulatory and/or legislative changes that might make insurance more available. To avoid anti-trust problems, insurance regulators must play an active role in sponsoring the clearinghouse.

4. New Commercial General Liability Policy

With the uncertainties involved in trying to anticipate future losses accurately in an ever-changing legal environment, actuarial pricing has become all but impossible for some risks. Expansive interpretations affecting any area of tort liability are likely to find application in other areas as well, making even the so-called profitable risks of a few years ago potentially uninsurable.

The Insurance Services Office has recently introduced a new Commercial General Liability Policy (CGL), including a claims made form. By itself, the CGL will not and cannot solve all of the current

insurance availability or affordability problems, but its approval and use by the industry would be a positive step in restoring a degree of underwriting confidence in the general liability marketplace.

Predictability is an essential ingredient in the insurance business, and without predictability some risks will no longer be assumed. The new CGL policy, with policy aggregate limits, encourages both the insurer and the insured to evaluate the risk objectively. The parties can then determine adequate limits and a definite coverage amount. Moveover, the introduction of a claims made version of the CGL allows for precision in determining the coverage period, avoids the stacking of limits and policies that now occurs and avoids costly litigation over policy application. Finally, the provision for "tail coverage" at the termination of a claims-made policy allows the insurer and policy holder to treat coverage for "Incurred But Not Reported" (IBNR) losses and its price separately, providing it only when it is needed rather than in every policy, defining the insurer's financial commitment, and pricing the coverage based on a reasonable loss expectation.

5. New Capacity

Many insurance companies are adding capital, both to assure that present business is adequately funded and to enable the writing of new business. This, coupled with adequate pricing, will do much to overcome availability problems. The industry recognizes, however, that there are limits on the amount of new capital that can be generated from insurance sources, at least until there is a thorough-going reform of the liability system. The industry, therefore, supports efforts by businesses and others to add capacity to the marketplace

through appropriate individual and group self insurance, provided that in the case of groups, they are subject to adequate regulatory supervision and result in no unfair advantages over commercial insurance.

There are, in addition, exposures that are simply too difficult for the private market to write under current rules because of the impossibility of measuring or even defining the exposure represented by businesses. Risks posed by toxic substances, such as asbestos and chemical wastes, are generally viewed by insurers as falling into that category. Unless such exposures can be clearly defined and limited by reform of the liability system, it may be that risks such as those posed by toxic waste facilities will have to be funded, in whole or in part, by public funds. Otherwise, an unacceptable choice must be made between requiring businesses to bear financially unacceptable risks themselves and imposing an involuntary and potentially catastrophic burden on the insurance industry. Clean-up costs for known toxic waste facilities have been estimated at $22 billion to $100 billion by federal government sources. Imposing even a substantial fraction of these costs on the insurance industry under the Jackson Township theory would leave little if any capacity left for all other risks consumers and businesses expect the industry to assume.

6. General Tort Reform

The trades have agreed on three general reforms that will improve the availability and affordability of insurance. These merit full and serious consideration by the legislatures in the several states. Detailed proposals will be available in January, 1986.

(a) Several Liability -- Present law in most states permits the recovery of damages from any one of a group of

defendants. Increasingly, the doctrine of joint and several liability is being abused as plaintiffs' attorneys pursue defendants with the deepest pockets for all or a disproportionate share of plaintiffs' damages, even though a defendant may have been only marginally responsible for the injury. The abuse is most manifest in cases involving municipalities where cities and towns that are only slightly responsible for the plaintiff's injury end up paying all or most of the award. The adoption of several liability would assign a defendant its share of the responsibility and no more, and the relative definition would help underwriters in assessing risks and offering insurance coverage to commercial and municipal entities.

(b) Punitive Damages -- In theory, punitive damages punish defendants who are guilty of malicious behavior and deter others from similar behavior. In fact, punitive damages are a bargaining chip in litigation and drive up the overall amount of settlements and awards. Moreover, the standards for determining when punitive damages should be awarded have eroded in recent years. The industry is in favor of the abolition of punitive damages on the ground that they are essentially criminal in nature and have no place in a civil liability system. At a minimum, the law of punitive damages should be amended so that such damages may only be awarded for truly malicious behavior.

Consideration of punitive damages should be separated in the litigation process from the determination of liability and compensatory damages, and multiple awards of punitive damages against a single defendant for the same conduct should be eliminated.

(c) State of the Art Reforms -- Especially in professional liability, municipal liability and product liability, courts have tended in recent years to permit the imposing of liability based on standards that developed after the activity in question took place. The industry is in favor of legislation that will assure that products manufacturers and professionals are judged by standards prevailing at the time. This would not only tie the tort law more firmly to commonly understood notions of responsibility, it would also enable underwriters to predict risks more precisely. Insurance buyers would have a greater incentive to conform their activities to current standards.

In addition to the three reforms already agreed upon, the trades have prepared an agenda of additional topics that will be examined in the near future in an attempt to arrive at additional agreed reforms. These are:

Repeal of the collateral source rule. This rule prohibits the introduction of evidence of payments to

or on behalf of the plaintiff from sources other than the defendant.

Ceilings on non-economic damages. Such damages are beyond a plaintiff's "out of pocket" damages, such as lost wages and medical expenses and include damages for "pain and suffering".

Retroactivity (an exploration of ways to restrict substantive changes in exposures to a prospective basis).

Dispute resolution (an examination of procedures which add delay and cost to the litigation process (e.g., discovery) or which may save time and costs (e.g. court-annexed arbitration; mini-trials).

Periodic payment of damages (ways to extend the use of structured settlements and awards).

The trades view the above as a "starter agenda" to be added to as the review process continues. In addition to the specific agenda items enumerated above and others that may be added, the trades will be exploring ways to document and measure the impact of an expanding liability system on the private insurance market and commercial activity in the United States.

7. Reforms Targeted to the Needs of Specific Buyer Groups

The trades are actively examining each area in which buyers have had difficulty in purchasing adequate coverage to determine whether there are specific legislative, regulatory or private sector proposals -- beyond the general reforms enumerated

above -- that might be advanced. For example, a package of proposals relating to dram shop liability might include a state-sponsored training program for liquor licensees; limiting liability to situations where liquor has been served to a visibly intoxicated person or a minor; and application of the statutory cause of action only where a vehicular accident occurred. With respect to units of government, a package might include partial or total immunity for defined governmental activities and a reasonable cap on awards. For asbestos removal contractors, it may be possible to tie liability explicitly to a failure to comply with state standards adopted after extensive technical and political consultations.

ILL-ADVISED CONSTRAINTS ON THE INSURANCE MARKET

The insurance industry needs a period of time to re-establish reasonable profitability. This in turn will permit the generation of new capacity to handle increasing exposures. The return to profitability and the attraction of new capital have already begun, but as the figures cited earlier in this paper attest, the process has a way to go before the industry can compete effectively with other users of capital.

This healing process could be undercut or even stopped by ill-considered actions by regulators or legislators. There are four

such ill-advised actions that, if taken, would significantly impair the ability of the industry to fund the liability system in the future. The common denominator of such measures is that they force a largely market-oriented, competitive industry to write risks that would not necessarily be written voluntarily, usually at inadequate prices. The four such actions are:

1. Financial Responsibility Provisions -- Such laws or regulations require a class or classes of buyers to show that they are financially able to meet tort judgments by the purchase of insurance or (in some instances) self insurance arrangements. While aimed at buyers, such provisions place great pressure on legislators and regulators to require the writing of insurance, whether through residual market mechanisms or otherwise. Where the underlying exposures are large and unpredictable, such as in the environmental area, financial responsibility requirements place a severe burden on buyers that cannot be legitimately met by insurers.

2. Involuntary Market Mechanisms -- These entities, which typically require all or a portion of the admitted property-casualty insurance industry in a state to absorb deficits of the pooling mechanism, tend to become inadequately funded, "take all comers" residual markets. As such, they mask underlying liability system problems by passing the costs of a malfunctioning liability system on to insurance buyers. They have also, in the medical malpractice area, generated large deficits that must, for the most part, be borne by the insurance industry. Thus, involuntary mechanisms

could, if used extensively, add significantly to the liabilities of the industry at a time when financial results are inadequate.

3. Administered Pricing -- There has been a trend in recent years towards allowing individual companies to set prices without regulatory approval. This trend has been especially marked in commercial lines. Competitive rating laws universally allow some discretion in the insurance commissioner to regulate prices in an uncompetitive market. A return to general prior approval laws would re-establish a bureaucratic system that is slow and cumbersome and which often imposes inadequate rates. A more open system permits insurers to make quicker pricing decisions as market conditions evolve and yet contains safeguards when competition is not adequate to restrain price increases.

4. Onerous Restrictions on Cancellation and Non-Renewal -- The industry acknowledges that some constraints on freedom of contract may be needed under current conditions, but a regulation (as adopted in one state) that in effect makes the insurance commissioner the decision-maker on all renewals, cancellations and changes in terms in the state removes all underwriting discretion and adjustment from insurers. Such a regulation is likely to discourage additional insurers from becoming involved in the state and to make currently admitted insurers reluctant to write new business.

CONCLUSION

Historically, the United States has relied primarily on the private insurance industry to assume and spread risks generated by the liability system. There has been a consensus that a free market system provides the most efficient way to identify, quantify and distribute such risks.

Implicit in this consensus, however, has been the assumption that the insurance mechanism can handle an expanding liability system, at least within broad limits. Due to the escalating and unpredictable expansion of the liability system in recent years, this assumption is no longer automatically true, and the consequence is the availability problems of 1985. Therefore, as a matter of public policy, the choice is between doing nothing to constrain the liability system (in which case the insurance industry will continue to struggle in attempting to accommodate the expanding system) and working towards a balanced, more predictable system (in which case the insurance industry will be able to operate much more effectively in making coverages available at reasonable prices).

There are a number of early signs that for many affected buyer groups, the availability crisis is beginning to ease. Voluntary programs or mechanisms are in place or being planned in many states. Underwriters are beginning to look for market niches and opportunities in these areas. Additional capital is beginning to flow back into the reinsurance markets.

All of this is evidence of a healthy recovery by the insurance industry, even in the face of difficult liability system

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TESTIMONY OF GEORGE M. MILLS, CPCU, ChFC,CLU
RISK MANAGER, NEW JERSEY HIGHWAY AUTHORITY
BEFORE SENATE LABOR AND INDUSTRY AND PROFESSIONAL COMMITTEE
MARCH 5, 1986

GOOD AFTERNOON, MY NAME IS GEORGE M. MILLS. I AM RISK ANAGER OF THE NEW JERSEY HIGHWAY AUTHORITY, WOODBRIDGE, EW JERSEY. IN THAT CAPACITY, I OVERSEE THE RISK MANAGEMENT OF THE NEW JERSEY HIGHWAY AUTHORITY INCLUDING ELIMINATION OF RISK, REDUCTION OF RISK AND INSURANCE OF RISK. PRESENTLY E INSURE FOR $1,000,000 PRIMARY LIABILITY AND $100,000,000 OF EXCESS LIABILITY. OUR PREMIUMS FOR THAT COVERAGE HAVE INCREASED THIS YEAR, HOWEVER, IN THE PRESENT INSURANCE CLIMATE WE ARE HAPPY TO HAVE COVERAGE WITH INSURANCE CARRIERS OF SUBSTANTIAL REPUTATION WHOM WE FEEL WILL BE FINANCIALLY ABLE TO PAY ANY CLAIMS THAT MIGHT OCCUR.

I AM VERY MUCH AWARE OF THE PRESENT TIGHT INSURANCE MARKET FACING COUNTIES AND MUNICIPALITIES THROUGHOUT THIS STATE. THE SITIUATION HAS BEEN WELL PUBLICIZED AND THE PROBLEM CLEARLY IDENTIFIED. THE SEARCH FOR THE MOST VIABLE SOLUTIONS IS A PROBLEM THESE GOVERNMENTAL ORGANIZATIONS NOW FACE.

THE THEORY OF INSURANCE IS THE SHARING OF THE COST BY ALL TO PAY THE CLAIMS OF THE FEW. RATES ARE TO BE DETERMINE BY CLASSIFYING THE INSURED'S OF A SIMILAR NATURE AND DIVIDING THE COST BETWEEN THEM ON AN APPROPRIATE BASIS.

A POOLING FOR COUNTIES AND MUNICIPALITIES MAY WELL BE THE PROPER SOLUTION FOR THESE BODIES. I FEEL, HOWEVER, THAT THE INCLUSION OF AUTHORITIES SUCH AS THE NEW JERSEY HIGHWAY AUTHORITY IS TOTALLY INAPPROPRIATE. THERE IS NO SIMILARITY OF RISK, SIMILARITY OF OPERATION OR SIMILARITY OF PREMIUM BASE, FOR EXAMPLE, MUNICIPAL OR COUNTY POPULATION.

FURTHER, THE $20,000,000 PROPOSED LIMIT MAY BE ENTIRELY ADEQUATE FOR COUNTIES OR MUNICIPALITIES BUT WOULD BE COMPLETE INADEQUATE FOR AN AUTHORITY. AS THE COVERAGE OFFERED BY THE PROPOSED POOL WOULD NOT BE THE STANDARD COVERAGE AVAILABL IN THE INSURANCE MARKETPLACE, THE TASK OF PLACING UMBRELLA COVERAGE BETWEEN $20,000,000 AND $100,000,000 BECOMES VIRTUAL INSURMOUNTABLE. THE FORM OF COVERAGE PROVIDED BY THE PROPOSE POOL WOULD BE NON-STANDARD IN INSURANCE TERMS AND UNKNOWN TO THE EXCESS UNDERWRITERS.

AS THE PREMIUMS OVER A CONTINUING PERIOD OF YEARS WOULD BE BASED UPON THE EXPERIENCE OF THE POOL, WE WOULD BE, IN ESSENCE, LOOKING AT A RETROSPECTIVE PREMIUM EXPOSURE WITH A PLEDGE OF GOOD FAITH AND CREDIT BY THE PARTICIPANTS IN THIS POOL. THERE IS A CONSIDERABLE QUESTION IF OUR PARTICIPA WOULD BE PERMISSIBLE UNDER SECTION 705, 707 AND 708 ET AL OF OUR NOVEMBER 15, 1984 BOND RESOLUTION. A SIMILAR PROBLEM WOULD MOST CERTAINLY AFFECT THE OTHER STATE AUTHORITIES. IT IS MY RECOMMENDATION THAT STATE AUTHORITIES BE EXCLUDED FROM SENATE - 1718, HOWEVER, I ENDORSE THE PROPOSED LEGISLATI AS REGARDS MUNICIPALITIES AND COUNTIES. 103x

The New York Times

Founded in 1851

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Liability Insurance in Crisis

In Missouri, loss of insurance forced the closing of a county jail. In New York City it halted the Roosevelt Island cable tram. California's Orange County was socked with a sixfold increase in its premium. The police in West Orange, N.J., had to stop patrolling in cars they could no longer insure.

Across the nation, the leap in insurance rates strains local government. Not without reason, insurers are quick to blame fee-hungry lawyers, gullible juries and a public eager to turn misfortune into millions. But the insurers themselves also deserve blame. The legal system and the public's attitude have undoubtedly raised costs, but that hardly explains the lurch in rates that struck about 18 months ago. The insurance companies' predicament was a foreseeable result of their business cycle.

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Liability insurance has a "long tail" — the years of legal proceedings between a loss and ultimate payment of damages. That leaves the insurers with huge cash reserves free to invest in financial markets. When interest rates are high or stock prices rise, insurers have an incentive to pile up cash by selling coverage at what look like bargain rates, confident that investment profits will more than cover any losses on claims. When financial markets cool off, the insurers find that reduced investment profits require them to raise premiums and drop riskier types of coverage altogether.

As interest rates soared in the late 1970's, the insurers cast a wide net for cash. In the 1982 slump, when interest rates plunged, they should have raised rates to cover future obligations. But they were still fat with cash, still competing strenuously. Now they are rushing belatedly to drop high-risk customers and raise premiums of those they keep.

Local governments are among the hardest-hit victims. The Aetna Life and Casualty Company, for example, has abandoned covering 400 of them. The Utica National Insurance Group has dropped the 229 it covered in New York State. This is because municipalities stand out as especially risky. Insuring miles of streets and sidewalks always made the carriers nervous. Now there are new horrors: toxic waste dumps, day-care centers susceptible to child abuse, school buildings laced with asbestos.

The insurers are further troubled by the complexity of relevant case law and by statutes that allow injured parties to recover full damages even when governments are found only marginally responsible for any loss. The insurers call for "tort reforms" that would limit the liability of governments, clarify the law and cap the amounts that could be recovered.

Some of those proposals may have merit. But the more urgent need is to smooth out the effects of the insurance business cycle. How could state regulators who police the insurance business protect its solvency and yet guard against such damaging and disruptive crisis adjustments? How can they guarantee coverage for all who need it?

The stocks of commercial liability insurers are rising in value as they raise prices and reduce coverage. But the consequences for local government are deplorable. If insurers want tort reform, let them be required to share responsibility for relieving the stress their business strategies produce.

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NORTH BRUNSWICK TOWNSHIP BOARD OF EDUCATION

RESOLUTION

WHEREAS, the North Brunswick Township Board of Education contracts for its insurance coverage with various insurance companies to provide Liability protection, and to insure its properties against loss; and

WHEREAS, the insurance premiums charged to the North Brunswick Township Board of Education for 1985-86 were increased by 90% and costs for 1986-87 are unknown; and

WHEREAS, the Legislature has the power to make legislative changes in the insurance law which would eliminate uncertainty in establishing insurance premiums;

NOW, THEREFORE, BE IT RESOLVED, that the North Brunswick Township Board of Education strongly urges that the Legislature act immediately to investigate the insurance industry in New Jersey; and to pass Legislation which will reduce insurance premiums; and require full disclosure and justification for any future increases.

CERTIFICATION

I, Robert W. Blessing, Assistant Superintendent for Business/Board Secretary to the Board of Education of the Township of North Brunswick, hereby certify the foregoing resolution was adopted by the Board of Education of the Township of North Brunswick, at a public meeting held on the 18th day of February, 1986.

Robert W. Blessing

Robert W. Blessing
Assistant Superintendent for Business
Board Secretary

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